UNC HEALTH CARE

The University of North Carolina Health Care System

2016 ANNUAL REPORT

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ARTIST RENDERING:
In March 2016, NC voters approved a bond package that included $68 million for the UNC School of Medicine to build a new medical education building.

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INTRODUCTION

Expanding Across the State to Deliver Expert and Empathetic Care

At UNC Health Care, it is our vision to be the nation's leading public academic health care system. This year, we have made a number of decisions that will help us continue to provide the highest quality of care and position us for success for years to come.

We are working to increase our class size and residency options at the UNC School of Medicine. This will remain a priority for us in the coming year. As our population grows, educating the future primary care physicians of our state, particularly for rural and underserved areas, becomes even more important.

We welcomed new partners into our system to serve more communities. Our system now includes 10 community hospitals and thousands of affiliated physicians. Each hospital brings unique strengths, and each physician brings a unique perspective, making us stronger as a whole.

Across UNC Health Care, we continue implementing processes that make us more efficient and more effective in delivering care. Thanks to the hard work of colleagues across the system, I am proud to say that UNC Health Care posted record revenue for FY16, bringing in $3.6 billion, up from $3.2 billion the previous year. This is a significant achievement and is in large part due to collaborative initiatives such as Carolina Value and Carolina Care.

This year's Annual Report includes stories and updates that highlight our growth, both in size and proficiency, and our increased ability to deliver empathetic, expert care to the people of North Carolina.

GROWING TO ADDRESS NEW CHALLENGES

Through the years, we have learned that strategic partnerships help us achieve our mission and make us stronger as a whole. This past year was no different.

I am pleased to say that we added two community hospitals to our system: Wayne Memorial Hospital and UNC Lenoir Hospital. UNC Lenoir and Wayne Memorial have been parts of their communities for more than 100 years. We intend to keep it that way. As with all of our partnerships, we look forward to further collaboration, exchanging ideas and benefiting from their expertise.

We are also seeking additional investments from our state legislature to increase the number of medical students per class in order to expand residency and high-level specialist options across the state. The funding will also support additional residency options, which is critical to retain physicians to practice in underserved areas across the state. In fact, 70 percent of UNC School of Medicine alumni who completed their residencies at UNC end up practicing in our state.

Our system's growth is helping tackle some of our state's most pressing health care challenges. For instance, cardiovascular disease continues to be one of the leading causes of death. With that in mind, we are opening a state-of-the-art hospital aimed at

addressing this issue through innovative care, research and education. The North Carolina Heart & Vascular Hospital, located at UNC REX Healthcare, will be a destination for patients across the region and beyond.

Nationally, treating and caring for behavioral health patients continues to be a challenge for health care organizations. This past year we expanded UNC WakeBrook, a facility in Raleigh with inpatient and outpatient services designed to care for those with mental health, behavioral and substance abuse issues. Thanks to a $1.6 million federal grant, we added 12 inpatient beds, allowing us to treat more than 750 patients per month, up from 250 per month in 2015. At UNC REX, we have improved our triage process in the emergency department to ensure these patients get the care they need as quickly as possible. Across the system, we continue to explore ways of caring for these patients. We still have a lot of work to do, but this is a step in the right direction.

STRIVING FOR EXCELLENCE

Once again, UNC Health Care, the School of Medicine, its affiliates and physician network all received recognition for their excellence and hard work.

U.S. News & World Report ranked three UNC Health Care hospitals among the top 20 hospitals in North Carolina. Eight clinical specialties were nationally ranked. Four specialties ranked best in the state, including the adult cancer program.

In addition, N.C. Children's Hospital has seven specialties nationally ranked by *U.S. News* for children's hospitals. Wayne Memorial Hospital was recognized as a high-performing hospital for 2016-17 for treating patients with congestive heart failure and chronic obstructive pulmonary disease.

The UNC School of Medicine is ranked the No. 2 medical school for primary care and No. 22 for research, and continued to receive significant financial support for its research. In fact, this past year, the National Institutes of Health gave the School of Medicine $268,497,435, placing the School among the top 15 in the nation for NIH funding.

UNC Hospitals, UNC REX, High Point Regional, Johnston Health and Pardee Hospital all received "A" grades for patient safety from the Leapfrog Group, putting them among the country's safest hospitals.

The UNC Chatham Park Medical Office opened in 2016, providing access to high-quality care for the upcoming Chatham Park community in Pittsboro. The facility combines services from Chatham Hospital, UNC Physicians Network and UNC Medical Center.

Caldwell Memorial Hospital began extensive renovations to modernize its facilities and equipment, with the goal of improving patient experience. The project will be complete in early 2018. And, Nash Health Care opened the new Nash Women's Center last year, providing new, state-of-the-art options for expectant families in the area.

This is just a snapshot of well-deserved recognition that we received this past year. It is a testament to the hard work that our doctors, researchers and staff conduct day in and day out to provide outstanding, high-quality care.

TAKING ON CONTINUED CHANGE AND POPULATION HEALTH

We have continued to roll out Carolina Value, our systemwide initiative aimed at improving patient access and experience and helping us work together more efficiently. As a result, we have already generated more than $280 million in annual recurring revenue enhancements and expense reductions.

The rapid rate of our state's population growth brings new and different health challenges. While our state has made improvements in areas like cardiovascular health and obesity, there is still work to be done. Some of our greatest challenges include diabetes, infant mortality and chronic tobacco use—all of which can be managed with greater access to preventive care.

We view it as not only our mission but also our responsibility to make the public healthier. As our system expands, we strive to increase access to high-quality care provided by local physicians that people know and trust.

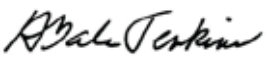
LOOKING FORWARD

The accomplishments of the past year helped us carry out our mission to be the nation's leading public academic medical system. Through the expert and empathetic care we provide, groundbreaking research we conduct and nationally recognized education we deliver, I am confident that, together, we will continue to realize this mission for years to come.

On behalf of UNC Health Care, thank you for your support. You make it possible for us to provide the people of North Carolina with access to the high-quality care they deserve.

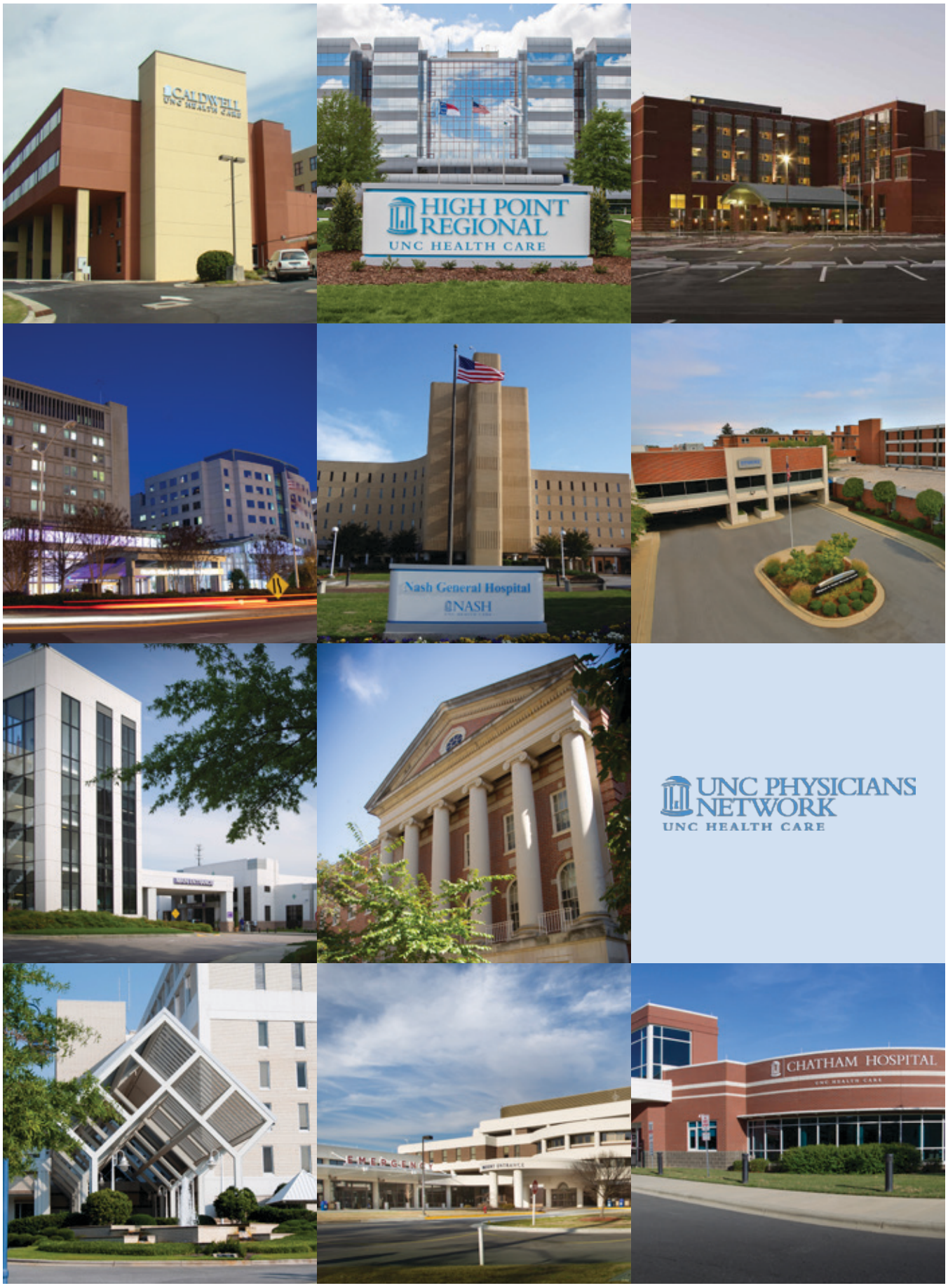
Sincerely,

William L. Roper, MD, MPH
Chief Executive Officer
The University of North Carolina Health Care System



A. Dale Jenkins
Chair, Board of Directors (November 2015–Present)
The University of North Carolina Health Care System

UNC HEALTH CARE


CALDWELL
UNC HEALTH CARE
HIGH POINT
REGIONAL
UNC HEALTH CARE
Nash General Hospital
NASH
UNC PHYSICIANS
NETWORK
UNC HEALTH CARE
CHATHAM HOSPITAL

System Update

By Scott Harris

TWO NEW HOSPITALS JOIN UNC HEALTH CARE

In 2016, Wayne Memorial Hospital and Lenoir Health Care became, respectively, the seventh and eighth hospital or hospital system to join UNC Health Care.

In each case, existing relationships gained strength through:

- Expanded hospital- and community-based care
- Improved patient experience and satisfaction
- Enhanced operational efficiency
- Recruitment of new physicians
- Access to cutting-edge research and treatments

William L. Roper, MD, CEO of UNC Health Care, said the partnership with Wayne Memorial Hospital "will help advance our System's mission of providing excellent care, training the next generation of North Carolina's physicians and conducting groundbreaking research."

Because of the partnership between UNC Health Care and Lenoir Health Care, Lenoir President and CEO Gary Black said the hospital's health care team now has a larger toolbox with which to help patients. This aligns with UNC Health Care's mission of "groundbreaking research and focus on advancing clinical care [that] enhances what we can deliver together, close to home."

SCHOOL OF MEDICINE PLANS NEW HOME

Berryhill Hall, the iconic but aging medical education building in the heart of the UNC Chapel Hill campus, will be replaced soon, thanks to the citizens of North Carolina.

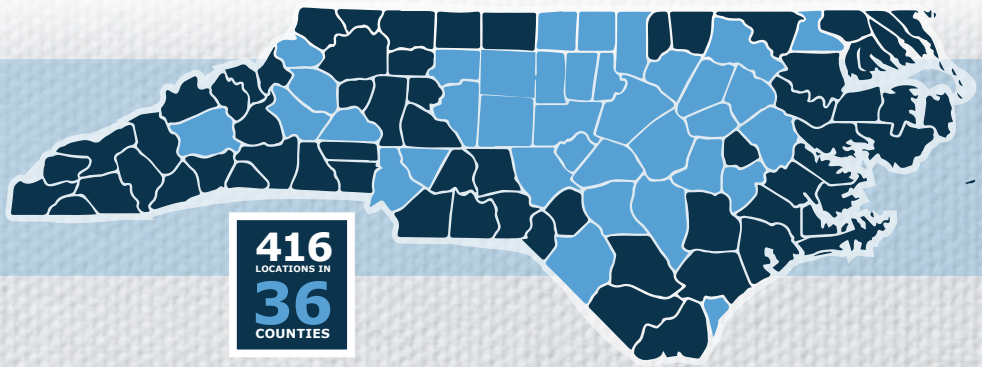
In March of 2016, North Carolina voters approved a $2 billion bond package, which included $68 million for the school to create and construct a new medical education building.

One key benefit of the new building, currently expected to open in four to five years, will be its capacity to educate more students. Today, the maximum size of a school class is 180, but once the school opens, that number could go as high as 230.

"It will allow us to increase our class size and educate more doctors for North Carolina," said Julie Story Byerley, MD, MPH, vice dean for education and chief education officer for the school.

That is only one of the expected benefits. The new building will house interprofessional education spaces, allowing medical students to learn alongside their peers in UNC's schools of pharmacy and public health, among others.

"We will have the flexibility for lots of small-group rooms, and that's the way we want to teach," Dr. Byerley said. "Students learn more from active learning."



A NEW ALLIANCE IMPROVES CARE

UNC Health Care is at the leading edge of health care innovation, and a significant part of that leadership comes from UNC Health Alliance.

The Health Alliance is a clinically integrated network of independent, community physicians and UNC Health Care, created to build a high-value, integrated system of care.

According to Seth Glickman, MD, MBA, president and executive medical officer for the Health Alliance, the network currently includes all of UNC Health Care's employed health care professionals, or 3,000 individuals, and about 1,300 independent care providers. Working together gives the network the power to exchange information on a large scale and test new care delivery and payment models that benefit providers and patients alike.

"We are asking our providers to work together in new ways that improve the coordination of care and their communication with one another," Dr. Glickman explained.

For example, primary care physicians now work more closely with specialists, and vice versa, as a result of the network. This helps ensure care is delivered efficiently for each patient, and without redundancies, such as duplicate MRI exams.

The next step, Dr. Glickman said, is a focus on improving the patient experience and identifying patients with the highest medical needs. These efforts will continue a systemwide commitment to the most effective and economical care possible.

"We want to reward doctors for high-quality care," Dr. Glickman said, "by giving them the information and support they need."

North Carolina Heart & Vascular Hospital Opens

It is known as patient-centered care, and in early 2017, patients across the Southeast will experience it—alongside a virtually unparalleled level of heart and stroke care—when the North Carolina Heart & Vascular Hospital opens its doors.

The Hospital is an eight-story, 114-bed tower consolidating REX's heart and stroke services into one location on its Raleigh campus. The Hospital includes a family courtyard, a demonstration kitchen and a range of other elements designed with patient-centered care—meaning an approach to care that is respectful of patient and family preferences—in mind.

Backed by UNC Health Care and staffed by Wake County's top physicians, the Hospital will act as the central hub of the Southeast region's premier heart and vascular program.

BY THE NUMBERS

13,700
Number of care providers in the UNC Health Alliance

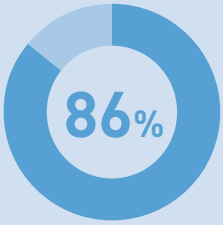
750
Number of patients WakeBrook primary care clinic will be able to treat after its expansion

230
Number of students the School of Medicine could train once its new building opens

3 million
Number of UNC Health Care clinic visits in 2016

77,000
Number of surgeries conducted at UNC Health Care in 2016

#2
School of Medicine national ranking for primary care, family medicine and rural medicine



Percentage of School of Medicine students who are North Carolina residents

1,700
Number of UNC faculty physicians

"We will now be able to offer a full medical home that is designated for people with a severe mental illness."

—WakeBrook Medical Director Brian Sheitman, MD

CHATHAM HOSPICE OPENS ITS DOORS

September marked the official opening of the SECU Jim and Betsy Bryan Hospice Home of UNC Health Care, the first inpatient and residential hospice facility of its kind to serve patients in Chatham and neighboring counties.

The hospice focuses on coordinated, compassionate care that allows patients to live out their lives meaningfully and peacefully.

This beautiful facility has a wide range of amenities designed to make patients and their families comfortable. This includes a team of nurses, social workers, pastoral and grief counselors and trained UNC Health Care volunteers with years of experience in hospice and palliative care services.

The 11,000-square-foot hospice, situated on two acres of land, houses a kitchen, dining room, meditation space, family visiting areas and 10 private rooms, each with an outdoor patio.

The State Employees Credit Union Foundation committed $1 million to The Medical Foundation of North Carolina to help finance the home's construction.

CHATHAM MEDICAL OFFICE OPENS

Last March, leaders from Chatham Hospital and UNC Health Care joined patients in and around Pittsboro, NC, to celebrate the opening of UNC Chatham Park Medical Office.

Combining services from Chatham Hospital, UNC Physicians Network and UNC Medical Center, UNC Chatham Park Medical Office brings a range of medical care to the surrounding community, including:

- Family medicine
- Imaging
- Laboratory
- Rehabilitation
- Rheumatology
- Specialty care
- Therapeutic infusion center

WAKEBROOK EXPANSION UNDERWAY

UNC WakeBrook, a behavioral health facility serving patients in Wake County who have behavioral health and substance abuse disorders, received a four-year, $1.6 million federal grant in October 2015 to expand its primary care outpatient clinic and explore new models to offer integrated primary and behavioral health care to this vulnerable population.

"We will now be able to offer a full medical home that is designated for people with a severe mental illness," said WakeBrook Medical Director Brian Sheitman, MD. "This grant will also help us determine the best model to deliver care for this population of patients."

As part of the expansion, WakeBrook has 12 additional inpatient beds, increasing the capacity to provide much-needed care for behavioral health patients. A team of licensed professionals provide patient-centered care in the unit, working to help patients develop coping skills and a safe plan for leaving the hospital as soon as possible. The goal is to ease the strain on hospital emergency departments.

RURAL HEALTH PROGRAMS MAKING ADVANCES IN UNDERSERVED CARE

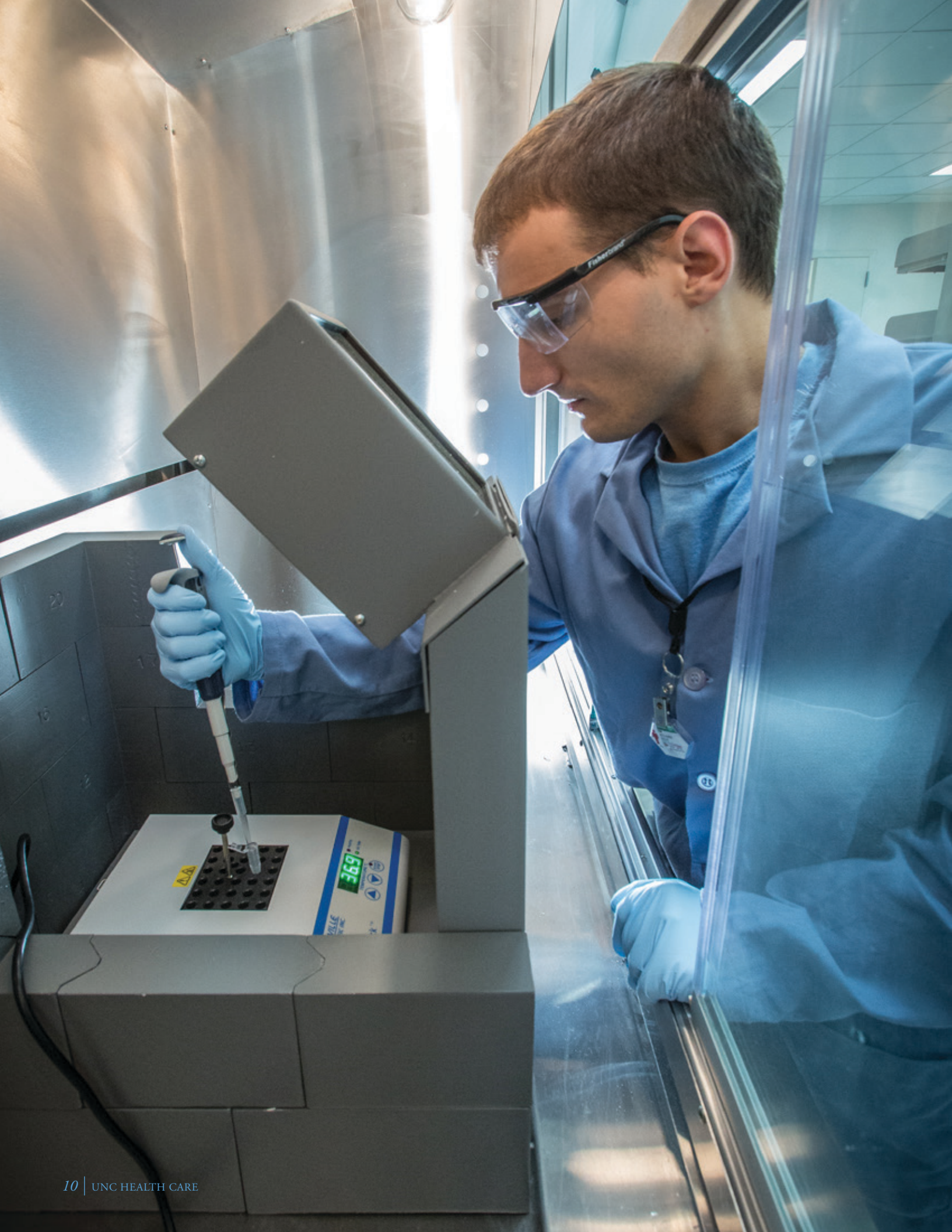
Now 30 strong, the UNC School of Medicine's Kenan Primary Care Medical Scholars group is continuing to expand.

"We're trying to find people with a rural heart and who have a sense of wanting to be in an underserved community," said Robert Bashford, MD, the school's associate dean for admissions. "There are counties in this state that do not have adequate medical care. The question is, do we have enough doctors where we need them? UNC is very well positioned to help address this."

In 2013, the school, The William R. Kenan, Jr. Charitable Trust and the Mountain Area Health Education Center collaborated to create the program, which provides financial support and hands-on experiences as ways of engaging students and encouraging them to practice in a rural or urban area that does not have enough medical care.

The program is open to students pursuing family medicine, internal medicine, pediatrics, obstetrics/gynecology, psychiatry and general surgery. Now the first students are beginning their residencies, even as the program expands to engage residents as well as students.

"It is really coalescing," Dr. Bashford noted. "If this keeps working, we will just keep making it bigger and bigger."



Research Review

By Scott Harris

Working alongside their colleagues at UNC Health Care and beyond, researchers at UNC Health Care made scores of scientific advances in 2016. With the system and its resources supporting them, UNC School of Medicine investigators are attacking disease, improving the way health care is delivered and evolving the world's biomedical knowledge every day.

NEW HOPE IN THE FIGHT AGAINST ZIKA

A collaboration between the school and UNC's Gillings School of Global Public Health found that individuals infected by a flavivirus—specifically dengue or Zika—could develop special antibodies that protect against those viruses. In that case, those antibodies could form the basis of a Zika vaccine or new treatments.

"In essence, a therapeutic treatment using antibodies derived from selected dengue and Zika virus survivors would protect pregnant women and others from contracting the Zika virus if they came in contact with it," said Ralph Baric, PhD, the study's principal investigator.

NETWORK WILL HELP DIABETICS, FURTHER DIABETES RESEARCH

A UNC School of Medicine faculty member is helping to create an online network designed to engage women who have diabetes.

The DiabetesSisters Network is an online social networking tool that elicits feedback from women with diabetes about gaps in their health care, with the goal of informing new research avenues.

"We are excited about our partnership with DiabetesSisters and the opportunity to promote patient-centered, high-quality care for women with diabetes or obesity," said Wanda Nicholson, MD, MPH, MBA, director of the Obesity and Diabetes Core at the UNC Center for Women's Health Research and member of the UNC Diabetes Center.

Nicholson and her collaborators received a two-year grant from the Patient-Centered Outcomes Research Institute to create the network.

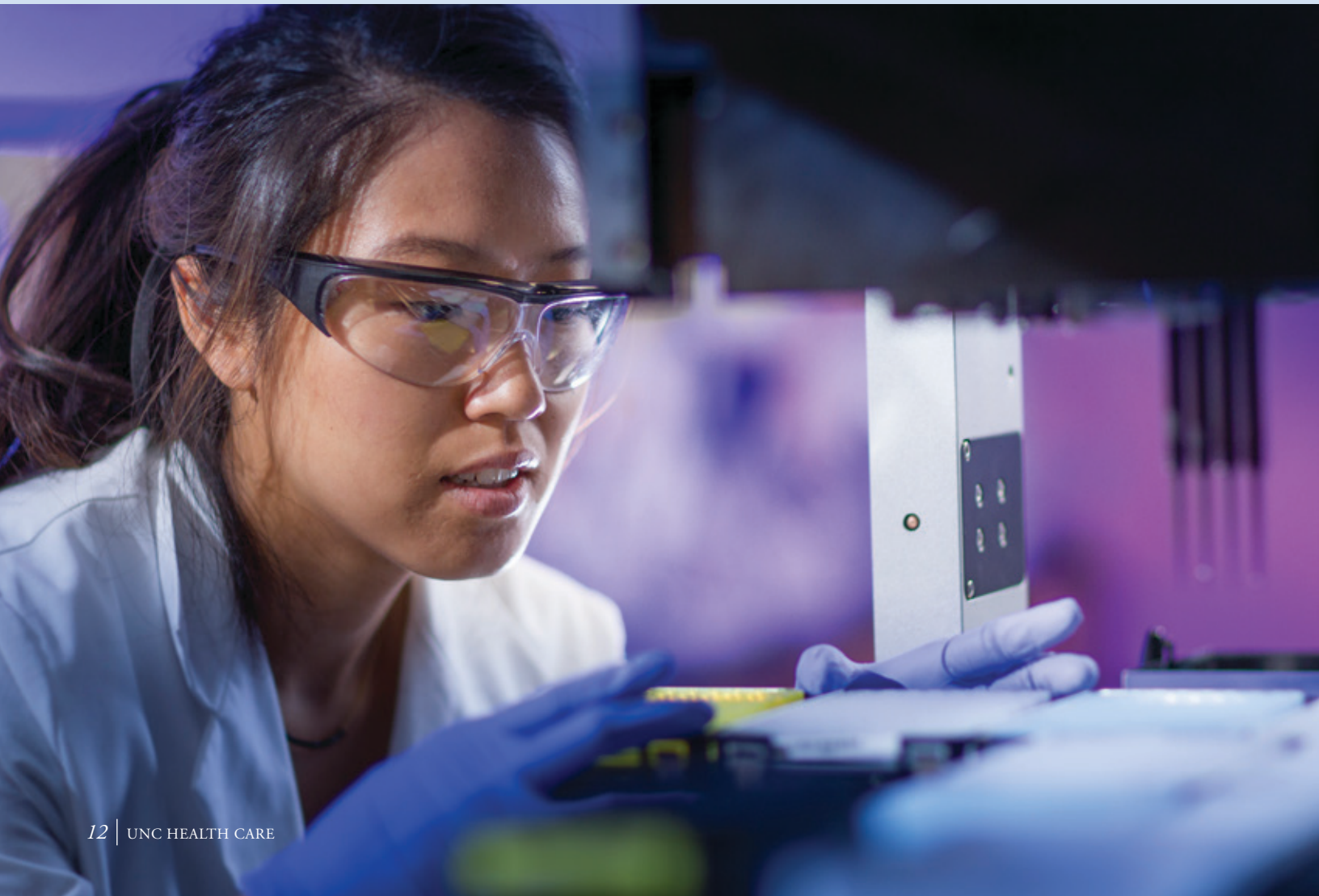
Examples of research collaboration throughout the system include:

Clinical trials in oncology and heart and vascular at **UNC REX Healthcare**

The **Comprehensive Cancer Center at Pardee**, a member of the Southeast Cancer Control Consortium, linking the hospital to research through the **National Cancer Institute**

Clinical research studies at **Johnston Health**, made possible through an agreement with the **Duke Oncology Network**

Clinical trials available through the **Hayworth Cancer Center at High Point Regional**



COMMON CHEMICALS MAY MIMIC AUTISM, ALZHEIMER'S GENE CHANGES

A specific group of fungicides could produce genetic changes similar to those in people with autism and neurodegenerative conditions such as Alzheimer's disease, researchers with UNC Neuroscience Center found.

Mark Zylka, PhD, and his team exposed mouse neurons to approximately 300 different chemicals, one group of which reduced the expression of genes involved in communication between neurons. If these genes are not expressed properly, the brain does not function normally.

IMMUNOTHERAPY WIPES OUT PEANUT ALLERGIES

Nearly four out of five peanut-allergic preschool children were successfully treated with peanut oral immunotherapy (OIT), allowing them to safely incorporate peanut-containing foods into their diets.

The study results confirm and extend previous results demonstrating that peanut OIT can protect against potentially life-threatening anaphylaxis. One month after completing OIT, almost 80 percent of trial participants achieved "sustained unresponsiveness" to peanuts, the highest rate yet reported.

Aziz Sancar, MD, PhD

Not Resting on His Laurels

After Winning Nobel Prize, UNC's Aziz Sancar Continues Research

Aziz Sancar, MD, PhD, the Sarah Graham Kenan Professor of Biochemistry and Biophysics at the School of Medicine, was awarded the 2015 Nobel Prize for Chemistry for his groundbreaking work in mapping DNA repair.

Although the prize is a capstone for any career, for Dr. Sancar, it was not an endpoint.

Since becoming UNC School of Medicine's second Nobel Laureate (Oliver Smithies, DPhil, received the award in 2007), Dr. Sancar authored or co-authored several reports advancing public knowledge in his three focus areas: mammalian DNA excision repair, mammalian DNA damage checkpoints and mammalian circadian clock.

Among his contributions in 2016:

- "Bifurcating electron-transfer pathways in DNA photolyases determine the repair quantum yield." Published in October in *Science*
- "Cisplatin DNA damage and repair maps of the human genome at single-nucleotide resolution." Published in September in *Proceedings of the National Academy of Sciences*
- "SREBP1c-CRY1 signaling represses hepatic glucose production by promoting FOXO1 degradation during refeeding." Published in July in *Nature*

By the Numbers

TOP 15

Consistently among top 15 recipients of National Institutes of Health (NIH) funding

Part of national consortium to improve the way biomedical research is conducted

$449M

Fiscal year 2016 School of Medicine research grants totaled $449,274,406

The school's largest federal funder, NIH, awarding $395 million in 2015 for more than 1,000 projects

GU NAMED SLOAN FELLOW

Zhen Gu, PhD, assistant professor in the UNC/NC State University Joint Department of Biomedical Engineering, is a 2016 Alfred P. Sloan Research Fellow in chemistry.

"It is an honor to be recognized by the Sloan Foundation for my work in advancing our understanding of fundamental chemistry tools that can address biomedical challenges in cancer and diabetes treatment," said Dr. Gu, a member of the UNC Diabetes Care Center and faculty member in the UNC schools of medicine and pharmacy.

Each year, the Sloan Research Fellowships are awarded to 126 of the most promising early-career scientists and scholars in North America and Canada.

Since joining NC State and UNC Health Care in 2012, Dr. Gu has created dozens of technologies and techniques to deliver drugs more precisely to maximize their effectiveness in the body. Dr. Gu's work is interdisciplinary, blending biomolecular engineering, materials chemistry, nanotechnology and other fields to develop better delivery methods. Dr. Gu has already launched a startup company to expedite commercialization of technologies developed in his lab.

STYNER AND COLLEAGUES: DIABETES DRUG CAN LEAD TO FRACTURES

A School of Medicine study shows how some diabetes drugs substantially increase bone fat and, by extension, the risk of fractures.

The study also shows that exercise can decrease bone fat caused by high doses of the diabetes drug rosiglitazone, which is sold under the brand name Avandia.

According to the study's first author Maya Styner, MD, assistant professor of medicine, the drug rosiglitazone essentially takes glucose out of blood to lower blood sugar and treat diabetes. However, that glucose is then packaged into fat; in the case of rosiglitazone users, that fat is deposited in the bone.

"These drugs aren't first- or second-line choices of treatment for type-2 diabetes, but some patients do take them," Dr. Styner said. "And we know there are drugs in development that target the same cellular pathways as rosiglitazone does. We think doctors and patients need to better understand the relationship between diabetes, certain drugs and the often dramatic effect on bone health."

PHILPOT AND ZYLKA LEAD NEUROSCIENCE CENTER

Mark Zylka, PhD, is now director of the UNC Neuroscience Center at the UNC School of Medicine. His long-time research partner, Ben Philpot, PhD, will serve as associate director.

In their new roles, Drs. Zylka and Philpot will build on the reputation of the UNC Neuroscience Center. When they arrived at UNC Health Care, each had their own research pursuits, but after sharing neighboring office and lab space, they eventually uncovered common areas of interest and expertise.

"Through contagious enthusiasm and interest, colleagues can shape you for the better," said Dr. Zylka, associate professor of cell biology and physiology. "In the past, science has seemed very insular, but now with the push for translational research, it's more important than ever for multiple researchers to work together."

Drs. Zylka's and Philpot's collaboration has produced groundbreaking research in the fields of chronic pain, autism and Angelman syndrome, garnering each international acclaim.

William Snider, MD, who directed the center for nearly 17 years, stepped down from the position but remains on faculty as professor of neurology.

COMMUNITY BENEFIT REPORT

Helping Low-Income Families Access Fresh, Local Food

UNC Health Care partners with the community in many ways throughout the year. Some of these efforts are more widely known than others. One relatively small, local program may not be well known, but its impact on the health of people in the community could be significant.

For the past four years, UNC Health Care has sponsored the Healthy Food Incentives program with the Carrboro Farmers' Market. The program provides matching dollars for people using their SNAP/EBT benefits at Market, which organizers at the Market say has led to a dramatic increase in low-income shoppers using their benefits there.

Our partnership with the Carrboro Farmers' Market also contributed to two youth programs that started in 2015. Children in the free Carrboro Cooks! kids' cooking classes receive healthy food incentives at the end of each class, and children in the Market Bunch kids' club receive healthy food incentives each time they do an educational activity at Market. More than 85 children participated in the pilot programs, and more than 220 shopping visits were made by children using UNC Health Care healthy food incentives at Market.

Building these kinds of relationships for community members and healthy lifestyle choices, such as local, fresh produce, will have a lasting impact on the health of low-income children and families who otherwise might not have access to these resources. Parents have told organizers of the programs that their kids have a more positive attitude about fruits and vegetables, and that will lead to lifelong healthy eating habits.

In addition, the Carrboro Farmers' Market is able to use some of the funding from UNC Health Care to provide coupons to families who are at higher risk of food insecurity.

More than

1,000 families

received smoke detectors through Operation Save a Life

2,000 children

in northern Orange County received school supplies as part of Stuff the Bus

170 high school students

learned about careers in health care at the annual Health Careers Symposium

64 people

learned about healthier lifestyles through the Healthiest You Challenge

1,125 miles

were run by Girls on the Run on the Hillsborough Hospital campus

More than

650 people

shared a meal during the Chapel Hill-Carrboro Community Dinner

764 homeless men

received care in the Robert Nixon Clinic at Community House

UNC HEALTH CARE

SUPPORTING LOCAL FARMERS

When the UNC Hillsborough campus opened last year, the Hillsborough Farmers' Market was looking for a permanent home, being moved from the location it had served from for years. UNC Health Care partnered with the organizers and now hosts the weekly Market.

In addition to being an important part of UNC Health Care's mission of promoting wellness in the community, hosting the Farmers' Market allows people to view the health care campus in a positive way. Most visits are for medical emergencies or illness. This is one way they can see UNC Health Care as part of the community.

The benefit of fresh produce also is extended to employees at UNC Hospitals. A weekly farmers' market has been located in the lobby for years, providing convenient access to employees or visitors who might not have an opportunity to get to a farmers' market otherwise.

FINANCIALS AND STATISTICS

CHAPEL HILL, NORTH CAROLINA
For the years ending June 30, 2016, and June 30, 2015

LETTER OF TRANSMITTAL

FEBRUARY 2, 2016

To the Governor, the State Auditor, members of the General Assembly, members of the UNC Board of Governors, UNC Chapel Hill Board of Trustees, members of the UNC Health Care System Board of Directors, supporters of the University of North Carolina Health Care System and William L. Roper, CEO

INTRODUCTION

This Annual Report includes a compilation of the operating results and financial position of the University of North Carolina Health Care System (UNC Health Care) as established by N.C.G.S 116-37. The financial reports as presented represent a summary of data generated by the various entities under the control of the Board of Directors of UNC Health Care.

The University of North Carolina Hospitals (UNC Hospitals), REX Healthcare, Inc. (REX), Chatham Hospital, Inc. (Chatham), High Point Regional Health (High Point), Caldwell Memorial (Caldwell) and UNC Physicians Network (UNCPN) prepare and publish their own separate audit reports on an annual basis. University of North Carolina Faculty Physicians (UNCFP), the clinical patient care programs of the University of North Carolina School of Medicine, is included in the audit report for The University of North Carolina at Chapel Hill (UNC-CH). Additional information regarding the organization structure can be found in the Notes to Financials section of the Annual Report.

The Annual Report is compiled to provide useful information about the entity's operations and programs and to ensure its accountability to the citizens of North Carolina. While UNC Health Care's management believes this information to be accurate, it should be noted that these documents are unaudited and not intended to be used for any financial decisions.

The Financials and Statistics section presents Management's Discussion and Analysis and pro forma financial statements for UNC Health Care and UNCFP. This section includes selected statistical and financial ratio information. Management's Discussion and Analysis provides a review of the financial operations and the Notes to Financials section provides additional explanations for the reader.

FINANCIAL INFORMATION

Internal Control Structure

UNC Health Care's management establishes and maintains an internal control structure to achieve the objectives of effective and efficient operations, reliable financial reporting and compliance with applicable laws and regulations. Management applies the internal control standards to meet each of the internal control objectives and to assess internal control effectiveness. When evaluating the effectiveness of internal control over financial reporting and compliance with financial-related laws and regulations, management follows the assessment process to assure the state

of North Carolina and the public that UNC Health Care is committed to safeguarding its assets and is providing reliable financial information.

One objective of an internal control structure is to provide management with reasonable, although not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition. Another objective is to ensure that transactions are executed in accordance with appropriate authorization and recorded properly in the financial records to permit the preparation of financial statements in accordance with generally accepted accounting principles. Annually, management provides assurances on internal control in its Performance and Accountability Report, including a separate assurance on internal control over financial reporting along with a report on identified material weaknesses and corrective actions.

As a recipient of federal and state funds, UNC Health Care is responsible for ensuring compliance with all applicable laws and regulations. A combination of state and UNC Health Care policies and procedures, integrated with a system of internal controls, provides for this compliance. The accounts and operations of UNC Hospitals and UNCFP (as a part of UNC-CH) are subject to an annual examination by the Office of the State Auditor. REX, Chatham, High Point, Caldwell and UNCPN are audited annually by independent third-party CPA firms. All seven entities are an integral part of the state's reporting entity represented in the state's Comprehensive Annual Financial Report and the state's Single Audit Report. The audit procedures are conducted in accordance with auditing standards generally accepted in the United States of America and Government Auditing Standards issued by the Comptroller General of the United States.

Budgetary Controls

On an annual basis, UNC Health Care's Board of Directors approves budgets for UNC Hospitals, UNCFP, REX, Chatham, High Point, Caldwell and UNCPN. The budget for UNCFP is also subject to approval by UNC-CH. Each entity of UNC Health Care produces monthly reports that compare budget and actual operating results. Department heads are expected to review the reports and identify significant variances from their budget. If necessary, action plans are implemented that will improve negative variances. In addition to the monthly reports, an encumbrance system is maintained by UNC Hospitals and UNCFP to track open purchase orders and commitments made to vendors.

N.C.G.S. 116-37 granted UNC Health Care flexibility for management of UNC Hospitals in regard to its policies for personnel and salary management; purchasing of goods, services and property; and property construction. On an annual basis, UNC Health Care submits a report on its activity under this flexibility. The report is sent to the Educational Planning, Policies, and Programs Committee of the UNC Board of Governors and to the Joint Legislative Commission on Governmental Operations on or before Sept. 30 each year.

UNC Health Care is subject to the provisions of the Executive Budget Act, except for trust funds identified in N.C.G.S. 116-36.1 and 116-37.2. These two statutes primarily apply to the receipts generated by patient billings and other revenues from the operations of UNC Hospitals and UNCFP. UNC Hospitals submits monthly reports to the Office of State Budget and Management that reflect its overall operations. UNC Health Care receives no appropriation from the state. In the past, appropriated funds from the General Fund covered a portion of operating expenses, including the portion of expenses attributable to the cost of providing (i) care to indigent patients and (ii) graduate medical education.

Cash and Investment Management

UNC Health Care continues to work with the Office of the State Treasurer and the University of North Carolina Management Company (UNCMC) to maximize the investment earnings for UNC Hospitals based on changes in the General Statutes that were made during the 2005, 2008 and 2011 sessions of the General Assembly. In addition, UNC-CH has allowed UNCFP to invest a portion of their funds in an intermediate fund beginning in fiscal year 2008. Investment earnings subsidize operating income and enable UNC Health Care to provide more services to the citizens of the state of North Carolina. The cash management policy includes all areas of receipts and disbursements so that investment earnings are maximized and vendor relations are maintained.

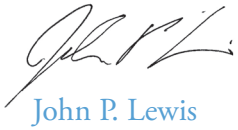
Risk Management

Exposures to loss are handled by a combination of methods, including participation in state-administered insurance programs, purchase of commercial insurance and self-retention of certain risks. The key to managing risk is to ensure that programs are in place that educate and guide employees to the best practices for our industry. We have a responsibility to safeguard our patients so that no additional harm comes to them while under our care. We are similarly committed to ensure a safe workplace for our employees.

In addition to the typical litigation risks with which we are faced, we have to recognize the risks and rewards associated with the health care industry. Continual evaluation of existing programs and new service development is the only way to maintain or increase our competitive advantage.

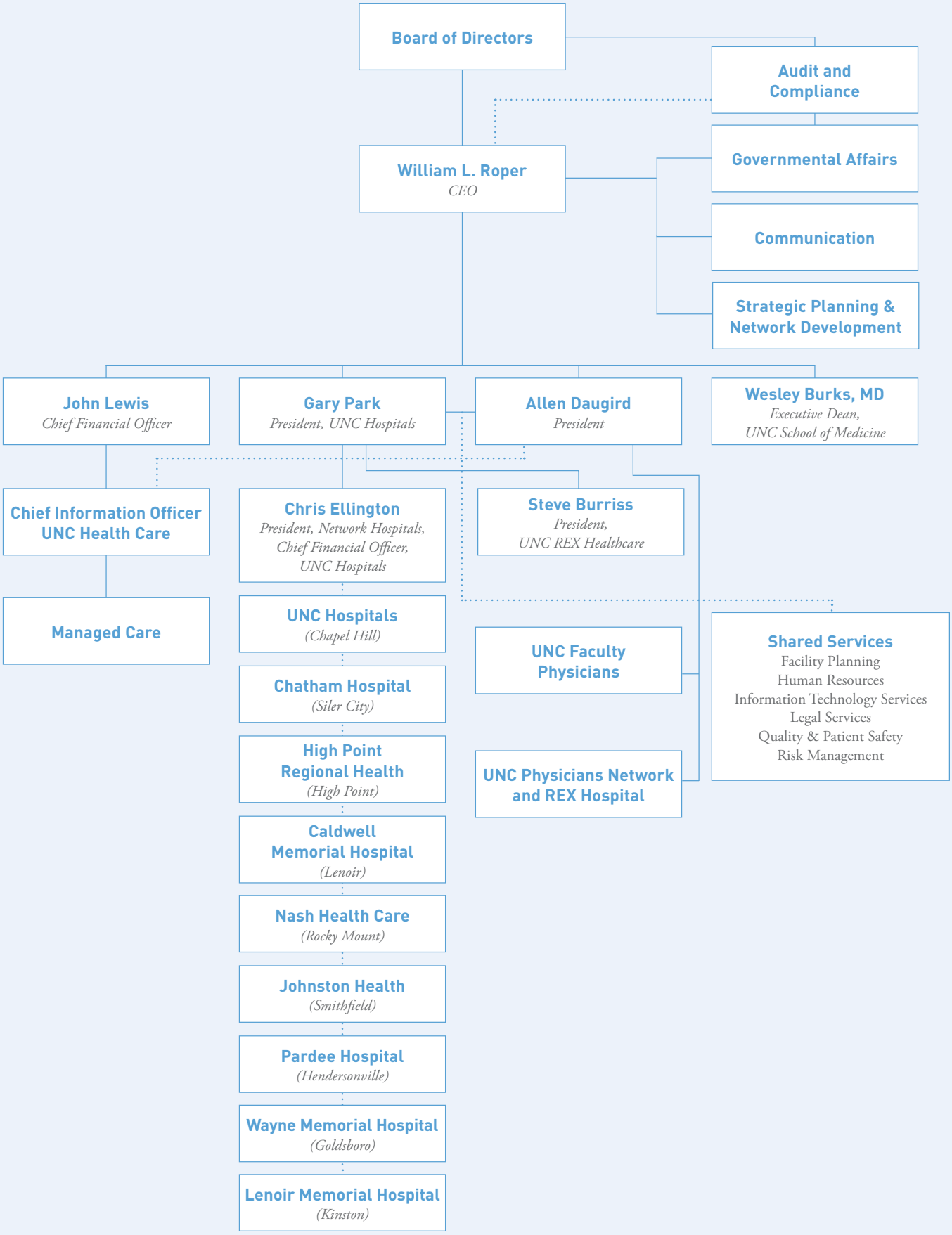
ACKNOWLEDGMENTS

Preparation for this Annual Report in a timely manner would not have been possible without the coordinated efforts of the various financial staffs within UNC Health Care, with special assistance from the CEO's office and Public Affairs office.



John P. Lewis
Chief Financial Officer
The University of North Carolina Health Care System

UNC HEALTH CARE SYSTEM REPORTING STRUCTURE



UNC HEALTH CARE SYSTEM BOARD OF DIRECTORS

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Chairman, UNC Health Care System Board of Directors
Raleigh, NC

Charles D. Owen, III (Vice Chair)
President, Fletcher Development Group, Inc.
Vice Chairman, UNC Health Care System Board of Directors
Fletcher, NC

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Vice Chairman, Bernhardt Furniture Company
Lenoir, NC

Sam Bowles
Managing Director, Minturn Partners
Charlotte, NC

A. Wesley Burks, MD
Executive Dean, UNC School of Medicine
Chapel Hill, NC

G. Hadley Callaway, MD
Raleigh Orthopaedic Clinic
Raleigh, NC

William H. Cameron
President, Cameron Management, Inc.
Wilmington, NC

Michael A. Crabb, III (Trey)
Executive Director, Morgan Stanley, Not-For-Profit Strategic Services
Nashville, TN

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Past Chairman, High Point Regional Health System
High Point, NC

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President, UNCPN
Chapel Hill, NC

Matthew M. Fajack
Vice Chancellor for Finance & Administration
UNC-Chapel Hill
Chapel Hill, NC

Carol Folt
Chancellor, The University of North Carolina at Chapel Hill
Chapel Hill, NC

Ernest J. Goodson, DDS
Orthodontist
Fayetteville, NC

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UNC School of Medicine
Chapel Hill, NC

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Chapel Hill, NC

Roger Perry
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Chapel Hill, NC

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Dean, UNC School of Medicine
Vice Chancellor for Medical Affairs, UNC-Chapel Hill
CEO, UNC Health Care System
Chapel Hill, NC

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Attorney, Ward and Smith, P.A.
New Bern, NC

Margaret Spellings
President, The University of North Carolina
Chapel Hill, NC

Greg Wessling
Business Advisor, A&G Associates and Partners, LLC
Davidson, NC

Edward Willingham
Chief Operating Officer, First Citizens Bank
Raleigh, NC

MANAGEMENT'S DISCUSSION AND ANALYSIS

INTRODUCTION

Management's discussion and analysis provides an overview of the financial position and activities of the University of North Carolina Health Care System (UNC Health Care) for the fiscal years ending June 30, 2016 and June 30, 2015. The financial statements included for UNC Health Care — *Statement of Net Position; Statement of Revenues, Expenses, and Changes in Net Position; and Statement of Cash Flows* — are labeled "pro forma" to demonstrate that they are an aggregation of assets and liabilities and the results of financial activities and not the result of an overall audit of UNC Health Care by an independent auditor and as a result should not be relied on as such.

UNC Health Care was established November 1, 1998, by N.C.G.S. 116-37. The original legislation included only the University of North Carolina Hospitals (UNC Hospitals) and the clinical patient care programs of the University of North Carolina at Chapel Hill (UNC-CH). UNC Health Care is governed by a Board of Directors and is administered as an affiliated enterprise of the University of North Carolina. UNC Faculty Physicians (UNCFP) represents the clinical patient care programs of the UNC School of Medicine. REX Healthcare, Inc. (REX), Chatham Hospital, Inc. (Chatham), High Point Regional Health (High Point), Caldwell Memorial Hospital (Caldwell), UNC Physicians Network (UNCPN) and UNC Physicians Network Group Practice (UNCPNGP) have been added to the organization since its inception.

Effective February 1, 2014, UNC Health Care and Johnston Memorial Hospital Authority (JMHA) entered into a Master Agreement to form Johnston Health Services Corporation (JHSC), a joint venture to provide health care services to the residents of Johnston County. Oversight and governance of the joint venture is controlled by a Board of Directors consisting of appointees from both JMHA and UNC Health Care. UNC Health Care manages the day-to-day operations of JHSC.

As illustrated in the reporting structure on page 23, UNC Health Care owns and/or controls the net assets and financial operations of UNC Hospitals, REX, Chatham, High Point, Caldwell, UNCPN and UNCPNGP. In contrast, UNC-CH owns and controls the net assets and financial operations of UNCFP. The UNC Health Care Board of Directors governs and oversees physician credentialing, quality and patient safety, and resident training and acts to advise and review the financial activities of UNCFP. Final direct control of the monetary operations of UNCFP remains within the UNC-CH. The physicians who provide patient care at UNC Hospitals and in the UNC-CH clinics are employees of the UNC-CH. Most non-physician employees who assist in providing patient care and the associated administrative, billing and collection services are employees of UNC Health Care.

For purposes of these financial statements, UNCFP serves as a financial proxy for the "clinical patient care programs of the School of Medicine." The financial statements for the entities directly controlled by UNC Health Care (UNC Hospitals, REX, Chatham, High Point, Caldwell, UNCPN and UNCPNGP) are separately audited on an annual basis and have received unqualified opinions for their prior year reports. The financial activities of UNCFP are included in the financial statements and audit report of the UNC-CH. Since an audit on the aggregation of financial information for these entities cannot be efficiently obtained, we have used the term "pro forma" to describe the financial statements presented.

Pro forma consolidated financial statements for UNC Health Care are presented, which include UNC Hospitals, REX, Chatham, High Point, Caldwell, UNCPN, UNCPNGP and UNCFP. UNCFP's Statement of Net Position, and Statement of Revenues, Expenses and Changes in Net Position for the fiscal years ending June 30, 2016 and 2015 are also included since these financial activities are not separately disclosed elsewhere.

USING THIS FINANCIAL REPORT

UNC Health Care's financial statements provide information regarding its financial position and results of operations as of June 30, 2016 and 2015 and the years then ended. The *Statement of Net Position*; the *Statement of Revenues, Expenses and Changes in Net Position*; and the *Statement of Cash Flows* comprise the basic financial statements required by the Governmental Accounting Standards Board (GASB).

In accordance with GASB, the pro forma financial statements are presented and follow reporting concepts consistent with those required of a private business enterprise. The financial statement balances reported are presented in a classified format to aid the reader in understanding the nature of the operations. The *Notes to Financials* provide information relative to the significant accounting principles applied in the financial statements and further details concerning the organization and its operations. These disclosures provide information to better understand details, risk and uncertainty associated with the amounts reported and are considered an integral part of the financial statements.

The pro forma *Statement of Net Position* provides information relative to the assets (resources), deferred outflows of resources, liabilities (claims to resources), deferred inflows of resources, and net position (equity). Assets and liabilities on this Statement are categorized as either current or noncurrent. Current assets are those that are available to pay for expenses in the next fiscal year, and it is anticipated that they will be used to pay for current liabilities. Current liabilities are those payable in the next fiscal year. Management estimates are necessary in some instances to determine current or noncurrent categorization. The pro forma *Statement of Net Position* provides information relative

to the financial strength of the organization and its ability to meet current and long-term obligations.

The *pro forma Statement of Revenues, Expenses and Changes in Net Position* provides information relative to the results of the organization's operations, nonoperating activities and other activities affecting net assets. Nonoperating activities include noncapital gifts and grants, investment income (net of investment expenses), unrealized gains and losses on investments, and loss realized on the disposition of capital assets. Under GASB, bond interest expense is considered a nonoperating activity; but for these pro forma statements it is presented as operating. The *pro forma Statement of Revenues and Expenses* provides information relative to the management of the organization's operations and its ability to maintain its financial stability.

The *pro forma Statement of Cash Flows* provides information relative to the cash receipts, cash disbursements, and net changes in cash resulting from operating activities, noncapital financing activities, capital and related financing activities, and investing activities. The Statement provides a reconciliation of beginning cash balances to ending cash balances and is representative of the activity reported on the *pro forma Statement of Revenues, Expenses and Changes in Net Assets* as adjusted for changes in the beginning and ending balances of noncash accounts on the *pro forma Statement of Net Assets*.

The *Notes to the Financial Statements* provide information relative to the significant accounting principles applied in the financial statements, authority for and associated risk of deposits and investments, information on long-term liabilities, accounts receivable, accounts payable, revenues and expenses, pension plans and other post-employment benefits, insurance against losses, commitments and contingencies, accounting changes, and a discussion of adjustments to prior periods and events subsequent to the enterprise's financial statement period when appropriate. These disclosures provide information to better understand details, risk, and uncertainty associated with the amounts reported and are considered an integral part of the financial statements.

COMPARISON OF TWO-YEAR DATA FOR 2016 TO 2015

Data for 2016 and 2015 are presented in this report and discussed in the following sections. Discussion in the following sections is pertinent to fiscal year 2016 results and changes relative to ending balances in fiscal year 2015.

Financial Analysis

STATEMENT OF NET POSITION

Total assets increased overall by $259.3 million or 6.9 percent during fiscal year 2016. Current assets increased $161.7 million primarily due to favorable cash flow from operations that resulted in an increase in cash and cash equivalents. Noncurrent assets increased $97.6 million due to capital investments for the construction of UNC Hospitals Hillsborough Campus and the North Carolina Heart & Vascular Hospital at REX (the "Heart Hospital"). The Heart Hospital is slated for opening in March 2017. Liabilities increased $28.2 million or 1.6 percent during fiscal year 2016. Accounts and other payables increased due to the aforementioned construction projects. Long-term notes and bonds payable increased $62.7 million as REX borrowed $88.7 million against their series 2015B revenue bonds to fund construction of the Heart Hospital. Additionally, other noncurrent liabilities decreased $117.5 million due primarily to the freezing of accrued benefits related to REX's retirement plan, which resulted in a $75.7 million decrease. Deferred inflows related to pensions for UNC Hospitals also decreased $31 million during fiscal year 2016.

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

UNC Health Care generated operating income of $196.6 million (5.5% operating margin) in fiscal year 2016, representing an improvement of $87.3 million over fiscal year 2015. This improvement is attributed to strong revenue growth combined with improved management of operating expenses, specifically salaries and contracted services. Net Operating Revenue increased by $362.7 million (11.4%) and is primarily attributable to volume growth and increased payments from negotiated payor contracts. Operating expenses grew 8.9 percent. Aggressive cost containment efforts continue in nongrowth areas. The impact of increasing volumes on operating expense was partially offset by a favorable impact to pension expense under the new GASB pension accounting standard. In order to remain financially strong, to reinvest in new facilities, and to retain the most highly trained workforce, UNC Health Care's goal is to average an annual operating margin of at least 4 percent.

Nonoperating gains were positive at $34.5 million and increased $18.6 million from fiscal 2015. Investment activity was $60.8 million unfavorable compared to 2015. However, REX had a one-time $75.7 million gain on change in pension plan as a result of freezing the plan's accrued benefits for all plan participants. Net income was $231.1 million, a 6.5-percent margin.

Discussion of Capital Asset and Long-Term Debt Activity

CAPITAL ASSETS

While UNC Hospitals had no major projects during the fiscal year, their expenditures were over $60.5 million in 2016 for the acquisition and construction of buildings, infrastructure, renovations, capital equipment and software.

REX continued its growth seen in prior fiscal years. Capital investments in fiscal year 2016 were $86.3 million and consisted primarily of costs incurred in connection with the construction of the new Heart Hospital, and medical technology and renovations. The Heart Hospital is being constructed on REX's main campus and includes the relocation of acute care beds from REX's aging patient tower, relocation of existing operating rooms, and consolidation of all existing heart and vascular services into a more convenient and accessible location.

All other entities expended $23.4 million on the acquisition and construction of buildings, infrastructure, renovations and capital equipment.

In addition to the improvements and modernization of its facilities during the past year, UNC Health Care continued its investment in the EPIC electronic health record system.

LONG-TERM DEBT ACTIVITY

UNC Health Care has no borrowing authority. REX, High Point and Chatham have issued revenue bonds in the past and may issue additional debt in the future should the need arise to finance construction projects and if the market rates are favorable.

On September 19, 2016, the Board of Directors of UNC Health Care approved a resolution for the issuance of UNC Hospitals revenue bonds to finance the initial phase of construction of a new surgical pavilion to replace operating suites and support facilities. The University of North Carolina Board of Governors ratified this bond issue at its October 14, 2016 meeting. UNC Hospitals intends to borrow up to $110,000,000 through the financing.

UNCFP issues its bonds through the UNC-CH. As such, its revenues and assets are a part of the bond covenants of the UNC-CH.

UNC Hospitals, High Point, Caldwell and Chatham did not enter into new debt-financing arrangements during the past fiscal year.

Standard and Poor's and Moody's Ratings Services classify UNC Hospitals' bonds as AA and Aa3 respectively. Standard & Poor's and Fitch classify REX's bonds as AA- while Moody's rate them as A2. Additional information about debt activity can be found in the notes to the pro forma statements.

Discussion of Conditions that May Have a Significant Effect on Net Position or Revenues, Expenses and Changes in Net Position

UNC Health Care derives the vast majority of its operating revenues from patient care services. Strong operating performance has enabled UNC Health Care to make investments in support of the clinical, education, and research programs of UNC Faculty Physicians, the UNC School of Medicine, and other network entities. These continued investments have yielded positive results as measured by growth in needed services, expansion of the medical school class and increased research funding.

UNC Health Care strives to remain a leader by evolving to meet the demands of an ever-changing environment. Pressure on health care providers comes in a variety of forms including expectations to provide greater value at a lower cost, to have fully interoperable electronic health records, to care for the uninsured, to integrate care for individual patients, and to improve wellness across populations. We are addressing these demands in a number of ways including expansion of access points as well as looking at streamlining operations to maximize efficiencies.

UNC Health Care is committed to connecting with patients where they are and is investing in several new access points and services including the construction of the North Carolina Heart & Vascular Hospital on the REX campus, which is expected to open March 2017. Other major investments in the communities we serve include developing a replacement perioperative tower on the Chapel Hill campus, increasing UNC Health Care's presence in Holly Springs, and developing a state-of-the-art cancer center on the REX campus. There are also several smaller initiatives to increase services such as expansion of behavioral health, imaging and pharmacy, among other services.

UNC Health Care is completing a review of all operations through a program known as Carolina Value. This program was developed and executed to enable UNC Heath Care to be more integrated operationally and clinically. The ongoing goal is to improve the health of North Carolina, provide exceptional patient care and service, become more efficient and work together as one team across UNC Health Care.

UNC Health Care has implemented an integrated medical record across the system at all of our owned network entities. UNC Health Care has long operated with electronic medical records. However, the systems used at the various locations were often unique and did not interface well with one another. Any form of data transfer between them was limited and cumbersome. Therefore, we established a vision for one patient to have one record everywhere within the system.

Third-party payors, including government-sponsored programs, continue to migrate from fee-for-service to fee-for-value. Traditional fee-for-service payment mechanisms have paid providers for each intervention. As a result, providers have been paid more for providing more care, not necessarily for providing better care. For the most part, providers have been insulated from the total cost of care they provide. In order to be successful in a fee-for-value environment, UNC Health Care is developing and implementing changes in our care delivery model that reduce reliance on continued growth in interventions and encourage providers to focus on the overall health of the populations we serve.

Payment in a fee-for-value environment rewards improvement in the quality of care we provide and the reduction of total cost of care for a population. The risk, accountability and reward for providing the right care, at the right time, in the right setting shifts to UNC Health Care. UNC Health Care is positioning itself to be a leader in the new health care environment that will ultimately reimburse less for services currently provided to our patients. Through this leadership, UNC Health Care endeavors to attract larger populations to our enterprise. To support our success in the transition to fee-for-value, UNC Health Care has created two vehicles for coordinating strategic and operational functions both among UNC Health Care owned and managed entities and with providers, facilities and ancillary services in the communities we serve. The UNC Health Alliance is a physician-led, physician-driven clinically integrated network that integrates care delivery among all UNC Health Care owned and managed entities and over 1,300 providers who have chosen to partner with us. The Health Alliance partners with payors with the exception of the CMS Original Medicare program. UNC Health Care has also created an accountable care organization (ACO) called the UNC Senior Alliance that was developed to meet the specific requirements set by CMS to participate in fee-for-value programs on behalf of Original Medicare beneficiaries. Through these two vehicles, UNC Health Care has entered into value-based relationships with payors that will cover almost 100,000 of our patients and over $200 million in system net revenue for 2017. The Alliance organizations will continue to build partnerships with internal stakeholders and external entities to drive strategic and care transformation activities throughout UNC Health Care. This is one example among several demonstrating UNC Health Care's commitment to value-based care and the position that we must accept and be rewarded for accepting increased accountability and risk.

We are engaging with new partners as the provider community consolidates. Of the more than 100 hospitals in North Carolina, today fewer than 25 remain unaffiliated with larger systems. Nationally and in North Carolina, the increasing demands on providers, both physician groups and hospitals, has caused many to seek partners in larger systems. Several of these—High Point Regional Health System, Caldwell Memorial Hospital, and Johnston Health Services Corporation have joined UNC Health Care. With our help, these hospitals will be able to provide more of the care needed in local communities, they will be able to access our state-of-the-art information systems (e.g., Epic) that are otherwise unaffordable, and they will become more efficient by leveraging UNC Health Care's scale.

We are responding to the State's needs and the needs of underserved populations. UNC Health Care has proudly cared for underserved patients as a safety net provider. In recent years, the cost we incur for those unable to pay for their care has exceeded $300 million.

Successfully managing in the future requires tighter integration of administrative functions across the entities of UNC Health Care, caring for patients in lower cost delivery settings, and comprising sufficient scale to spread the cost of major investments across a broad base. UNC Health Care continues to plan for these changes through a health system-wide planning and implementation process.

THE UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM

PRO FORMA STATEMENT OF NET POSITION

For the Years Ended June 30, 2016 and June 30, 2015

	2016	2015*
CURRENT ASSETS		
Cash and Investments	$491,176,000	$373,174,000
Patient Accounts Receivable - Net	420,880,000	384,129,000
Inventories	71,086,000	61,495,000
Other Assets and Receivables	328,986,000	309,801,000
Assets Whose Use Is Limited or Restricted	36,919,000	55,563,000
Prepaid Expenses	42,030,000	45,173,000
Total Current Assets	1,391,077,000	1,229,335,000
NONCURRENT ASSETS		
Property, Plant and Equipment - Net	1,549,941,000	1,472,538,000
Assets Whose Use Is Limited or Restricted	943,075,000	915,889,000
Other Assets	151,286,000	158,282,000
Total Noncurrent Assets	2,644,302,000	2,546,709,000
Total Assets	**4,035,379,000**	**3,776,044,000**
CURRENT LIABILITIES		
Accounts and Other Payables	377,045,000	345,979,000
Accrued Salaries and Benefits	138,223,000	150,583,000
Estimated Third-Party Settlements	215,389,000	163,575,000
Notes and Bonds Payable	26,058,000	27,207,000
Interest Payable	4,994,000	4,150,000
Other	28,720,000	24,258,000
Total Current Liabilities	790,429,000	715,752,000
NONCURRENT LIABILITIES		
Notes and Bonds Payable	549,966,000	487,290,000
Compensated Absences	115,733,000	107,328,000
Other Noncurrent Liabilities	319,421,000	436,932,000
Total Noncurrent Liabilities	985,120,000	1,031,550,000
Total Liabilities	**1,775,549,000**	**1,747,302,000**
NET POSITION	**$2,259,830,000**	**$2,028,742,000**
TOTAL LIABILITIES AND NET ASSETS	**$4,035,379,000**	**$3,776,044,000**

*2015 as restated

THE UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM

PRO FORMA STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

For the Years Ended June 30, 2016 and June 30, 2015

	2016	2015*
OPERATING REVENUE		
Net Patient Service Revenue	$3,369,075,000	$3,002,227,000
Other Operating Revenue	189,212,000	193,390,000
Net Operating Revenue	**3,558,287,000**	**3,195,617,000**
OPERATING EXPENSES		
Salaries and Fringe Benefits	1,887,018,000	1,792,468,000
Medical and Surgical Supplies	669,639,000	570,896,000
Contracted Services	377,618,000	346,120,000
Other Supplies and Services	185,295,000	160,687,000
Communications and Utilities	44,253,000	45,946,000
Medical Malpractice Costs	12,977,000	4,068,000
Depreciation	161,802,000	137,750,000
Bond and Other Interest Expense	8,274,000	14,607,000
Medical School Trust Fund (MSTF)	14,835,000	13,843,000
Total Operating Expenses	**3,361,711,000**	**3,086,385,000**
OPERATING INCOME (LOSS)	**196,576,000**	**109,232,000**
NONOPERATING GAINS (LOSSES)		
Interest and Investment Activity	(15,803,000)	45,012,000
Nonoperating Income (Expense)*	71,775,000	(3,586,000)
Grants	(21,460,000)	(25,469,000)
Total Nonoperating Gains	**34,512,000**	**15,957,000**
CHANGE IN NET POSITION	**$231,088,000**	**$125,189,000**

*2015 as restated

THE UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM

PRO FORMA STATEMENT OF CASH FLOWS

For the Years Ended June 30, 2016 and June 30, 2015

	2016	2015 *
CASH FLOWS FROM OPERATING ACTIVITIES		
Received from Patients and Third Parties	$3,384,138,000	$2,985,067,000
Payments to Employees and Fringe Benefits	(1,956,286,000)	(1,738,244,000)
Payments to Vendors and Suppliers	(1,319,869,000)	(1,046,281,000)
Payments for Medical Malpractice	(13,215,000)	(4,306,000)
Other Receipts	174,489,000	181,014,000
Net Cash Provided	**269,257,000**	**377,250,000**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Health Care System Grants Paid to UNC	(21,460,000)	(25,469,000)
Net Cash Used	**(21,460,000)**	**(25,469,000)**
CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES		
Proceeds from Issuance of Long-Term Debt	89,198,000	61,402,000
Principal and Arbitrage Paid on Outstanding Debt	(29,241,000)	(27,819,000)
Interest and Fees Paid on Debt	(6,937,000)	(12,099,000)
Acquisition and Construction of Capital Assets	(170,208,000)	(226,140,000)
Net Cash Used	**(117,188,000)**	**(204,656,000)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment Income and Other Activity	(15,803,000)	45,012,000
Purchase and Sale of Investments, Net of Fees	(8,542,000)	6,251,000
Investments in and Loans to Affiliated Enterprises - Net	11,738,000	(28,332,000)
Net Cash Provided	**(12,607,000)**	**22,931,000**
NET INCREASE (DECREASE)	**$118,002,000**	**$170,056,000**
BEGINNING CASH AND CASH EQUIVALENTS	**$373,174,000**	**$203,118,000**
ENDING CASH AND CASH EQUIVALENTS	**$491,176,000**	**$373,174,000**

*2015 as restated

STATEMENT OF NET ASSETS (UNAUDITED)

For the Years Ended June 30, 2016 and June 30, 2015

	2016	2015
CURRENT ASSETS		
Cash and Investments	$74,265,000	$61,723,000
Patient Accounts Receivable - Net	50,450,000	51,302,000
Estimated Third-Party Settlements	35,564,000	40,393,000
Other Assets and Receivables	32,230,000	43,126,000
Assets Whose Use Is Limited or Restricted	1,261,000	6,686,000
Prepaid Expenses	14,810,000	11,410,000
Total Current Assets	**208,580,000**	**214,640,000**
NONCURRENT ASSETS		
Property, Plant and Equipment - Net	-	3,042,000
Assets Whose Use Is Limited or Restricted	872,000	-
Total Noncurrent Assets	**872,000**	**3,042,000**
Total Assets	**209,452,000**	**217,682,000**
CURRENT LIABILITIES		
Accounts and Other Payables	41,314,000	44,496,000
Accrued Salaries and Benefits	9,656,000	18,065,000
Estimated Third-Party Settlements	2,143,000	8,083,000
Other	-	-
Total Current Liabilities	**53,113,000**	**70,644,000**
NONCURRENT LIABILITIES		
Compensated Absences	37,975,000	37,058,000
Total Noncurrent Liabilities	**37,975,000**	**37,058,000**
Total Liabilities	**91,088,000**	**107,702,000**
NET ASSETS	**$118,364,000**	**$109,980,000**
TOTAL LIABILITIES AND NET ASSETS	**$209,452,000**	**$217,682,000**

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION (UNAUDITED)

For the Years Ended June 30, 2016 and June 30, 2015

	2016	2015
OPERATING REVENUE		
Net Patient Service Revenue	$386,226,000	$343,429,000
Other Operating Revenue	101,711,000	84,609,000
Net Operating Revenue	**487,937,000**	**428,038,000**
OPERATING EXPENSES		
Salaries and Fringe Benefits	404,109,000	389,398,000
Medical and Surgical Supplies	21,347,000	15,272,000
Contracted Services	65,156,000	59,735,000
Other Supplies and Services	26,384,000	16,696,000
Communications and Utilities	2,936,000	2,758,000
Medical Malpractice Costs	5,430,000	966,000
Medical School Trust Fund (MSTF)	14,835,000	13,843,000
Total Operating Expenses	**540,197,000**	**498,668,000**
OPERATING LOSS	**(52,260,000)**	**(70,630,000)**
NONOPERATING GAINS (LOSSES)		
Interest and Investment Income	250,000	1,340,000
Transfers to HCS Enterprise Fund	(21,052,000)	(16,234,000)
Transfers from HCS Enterprise Fund	81,929,000	73,237,000
Other Changes in Net Assets	(483,000)	-
Total Nonoperating Gains	**60,644,000**	**58,343,000**
CHANGE IN NET POSITION	**$8,384,000**	**$(12,287,000)**

STATEMENT OF CASH FLOWS (UNAUDITED)

For the Years Ended June 30, 2016 and June 30, 2015

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Received from Patients and Third Parties	$384,606,000	$330,852,000
Payments to Employees and Fringe Benefits	(411,601,000)	(373,071,000)
Payments to Vendors and Suppliers	(122,411,000)	(91,852,000)
Payments for Medical Malpractice	-	(1,412,000)
Operating Capital Grants	92,826,000	60,421,000
Other Receipts	86,394,000	70,766,000
Net Cash Provided (Used)	**29,814,000**	**(4,296,000)**
CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES		
Acquisition and Construction of Capital Assets	3,042,000	(3,042,000)
Net Cash Provided (Used)	**3,042,000**	**(3,042,000)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment Income and Other Activity	250,000	1,340,000
Investments in and Loans to Affiliated Enterprises - Net	(20,564,000)	(16,234,000)
Net Cash Provided (Used)	**(20,314,000)**	**(14,894,000)**
NET INCREASE (DECREASE)	**$12,542,000**	**$(22,232,000)**
BEGINNING CASH AND CASH EQUIVALENTS	**$61,723,000**	**$83,955,000**
ENDING CASH AND CASH EQUIVALENTS	**$74,265,000**	**$61,723,000**

PRO FORMA SELECTED STATISTICS AND RATIOS

For the Years Ended June 30, 2016 and June 30, 2015

	REX SITES	CHATHAM SITES	HPRH SITES	CALDWELL SITES	UNC SITES	UNCPN SITES	2016 UNC HEALTH CARE TOTAL	2015* UNC HEALTH CARE TOTAL
PATIENT SERVICE STATISTICS								
Patient Days	122,188	4,980	68,465	17,771	268,777		482,181	477,906
Inpatient Discharges	26,912	633	16,024	3,679	34,339		81,587	81,222
Average Length of Stay (Days)	4.0	2.9	4.3	4.8	6.6		5.9	5.9
Inpatient Operating Room Cases	10,831	19	2,744	1,275	13,535		28,404	26,624
Outpatient Operating Room Cases	21,961	640	2,741	3,999	18,935		48,276	46,411
Emergency Department Visits	57,404	16,494	63,977	28,052	66,655		232,582	232,086
Clinic Visits	541,804	-	305,576	131,408	1,375,827	667,637	3,022,252	2,320,786
Births/Deliveries	5,624	-	1,438	335	3,679		11,076	11,105

	2016 UNC HEALTH CARE TOTAL	2015* UNC HEALTH CARE TOTAL
FINANCIAL RATIOS		
Operating Margin Percentage	5.52%	3.42%
Operating Margin Percentage (excluding cost report settlements)	5.52%	3.42%
Days in Net Accounts Receivable	45.72	46.70
Days of Cash on Hand (includes investments)	160.07	155.88
Average Payment Period (days)	108.08	112.39
Long-Term Debt to Equity	19.57%	19.39%
Current Debt Service Coverage	11.09	6.95

*2015 as restated

NOTES TO FINANCIALS

NOTE 1 // SIGNIFICANT ACCOUNTING POLICIES

A. ORGANIZATION – The University of North Carolina Health Care System (UNC Health Care) was established November 1, 1998, by N.C.G.S. 116-37. It is governed and administered as an affiliated enterprise of The University of North Carolina system with its stated purpose to provide patient care, facilitate the education of physicians and other health care providers, conduct research collaboratively with the health sciences schools of the University of North Carolina at Chapel Hill (UNC-CH) and render other services designed to promote the health and well-being of the citizens of North Carolina.

The original legislation included the University of North Carolina Hospitals at Chapel Hill (UNC Hospitals) and the clinical patient care programs established or maintained by the School of Medicine of the University of North Carolina at Chapel Hill including University of North Carolina Physicians and Associates (UNC P&A). As of January 1, 2013, UNC Physicians & Associates changed its name to UNC Faculty Physicians (UNCFP) to better identify the relationship with the UNC School of Medicine. UNC Health Care is under the governance of the Board of Directors of UNC Health Care. REX Healthcare, Inc. (REX), Chatham Hospital, Inc. (Chatham), High Point Regional Health (High Point), Caldwell Memorial Hospital (Caldwell), UNC Physicians Network (UNCPN) and UNC Physicians Network Group Practice (UNCPNGP) have been added to the organization since its inception.

The University of North Carolina Hospitals – The University of North Carolina Hospitals at Chapel Hill (UNC Hospitals) is the only state-owned teaching hospital in North Carolina. With a licensed base of 929 beds, this facility serves as an acute care teaching hospital for The University of North Carolina at Chapel Hill. UNC Hospitals consists of North Carolina Memorial Hospital, North Carolina Children's Hospital, North Carolina Neurosciences Hospital, North Carolina Women's Hospital, North Carolina Cancer Hospital, UNC Hospitals Hillsborough campus and UNC Hospitals WakeBrook campus. As a state agency, UNC Hospitals is required to conform to financial requirements established by various statutory and constitutional provisions. While UNC Hospitals is exempt from both federal and state income taxes, a small portion of its revenue is subject to the unrelated business income tax.

BLENDED COMPONENT UNITS – Although legally separate, Health System Properties, LLC (the LLC), a component unit of UNC Hospitals, is reported as if it were part of the Hospitals.

The LLC was established to purchase, develop and/or lease real property. Because UNC Health Care is the sole member manager of the LLC, the elected directors of the LLC are the same members of the UNC Health Care System Board of Directors that directs UNC Hospitals' operations, and as the LLC's primary purpose is to benefit UNC Hospitals, its financial statements have been blended with those of UNC Hospitals.

The University of North Carolina Faculty Physicians – Formerly known as UNC Physicians & Associates, University of North Carolina Faculty Physicians (UNCFP) is the clinical service component of the UNC School of Medicine. At the heart of UNCFP are the approximately 1,228 physicians who provide a full range of specialty and primary care services for patients of UNC Health Care. While the great majority of services are rendered at the inpatient units of UNC Hospitals and the outpatient clinics on the UNC campus, there is a growing range of services provided at clinics in the community. There are 23 clinical departments and two administrative units that collectively form UNCFP.

CLINICAL DEPARTMENTS:

- Anesthesiology
- Dermatology
- Emergency Medicine
- Family Medicine
- Hillsborough Medical Office Building
- Medicine
- Neurology
- Neurosurgery
- Obstetrics & Gynecology
- Otolaryngology
- Pathology & Laboratory Medicine
- Pediatrics
- Psychiatry
- Physical Medicine & Rehabilitation
- Radiation Oncology
- Radiology
- Surgery
- Treatment and Education of Autistic and Related Communication Handicapped Children
- Urology

AFFILIATED DEPARTMENTS:

- Allied Health Sciences
- Center for Development and Learning

ADMINISTRATIVE UNITS:

- Administrative Office (Billing & Collections, Managed Care)
- Ambulatory Administration

While UNCFP is affiliated with UNC Health Care, the net assets of UNCFP are held in a UNC-CH trust fund. The operating income and expenses for UNCFP are managed via the UNC-CH's accounting infrastructure, and its operational results are included in the annual audit for the UNC-CH.

UNC REX Healthcare, Inc. – REX Healthcare, Inc. (REX) is a North Carolina not-for-profit corporation organized to provide a wide range of health care services to the residents of the Triangle area of North Carolina.

UNC Health Care is the sole member of the corporation and appoints eight of the 13 seats on REX's Board of Trustees and also reviews and approves REX's annual operating and capital budgets.

Chatham Hospital, Inc. – Chatham Hospital, Inc. (Chatham) is a private, nonprofit corporation that owns and operates a critical access facility located in Siler City, North Carolina. UNC Health Care is the sole member of Chatham Hospital, Inc. UNC Health Care appoints nine of the 15 members on the Chatham Hospital, Inc. Board and reviews and approves its annual operating and capital budgets.

UNC Physicians Network (UNCPN) and UNC Physicians Network Group Practice (UNCPNGP) – UNC Physicians Network and UNC Physicians Network Group Practice are wholly owned subsidiaries of UNC Health Care, but are private employers that own and operate more than 60 community physician practices throughout the Triangle region of North Carolina (Raleigh, Durham and Chapel Hill).

It is a physician-led network structured to meet the needs of the community and community practice physicians by creating a partnership for physicians and UNC Health Care to face the challenging health care environment.

During fiscal year 2016, UNCPN ended its joint venture with Mosaic Health and acquired the remaining interest in North Carolina Health Care Innovation, LLC.

High Point Regional Health, Inc. – High Point Regional Health (High Point) is a North Carolina not-for-profit corporation located in High Point, North Carolina, to promote and advance charitable, educational and scientific purposes, and to provide and support health care services.

UNC Health Care became the sole corporate member of High Point on March 31, 2013. High Point is the parent holding company of High Point Regional Health Foundation, High Point Health Care Ventures, Inc., and High Point Regional Health Services, Inc.

Caldwell Memorial Hospital – Caldwell Memorial Hospital (Caldwell) is a private, not-for-profit community hospital in Lenoir, North Carolina and is an acute care hospital with a provider network of more than 60 primary and specialty care physicians and advanced practice professionals. UNC Health Care became the sole corporate member of Caldwell on May 1, 2013.

WakeBrook Mental Health Campus (WakeBrook) – UNC Health Care agreed to provide, enhance and expand all services offered in the past at Wake County's WakeBrook facility. Pursuant to agreements with Wake County and Alliance Behavioral Health, UNC Health Care began with the operation of WakeBrook Crisis and Assessment services on February 1, 2013. WakeBrook is now fully operational, providing the behavioral health and medical services in the areas of Crisis and Assessment, Residential Facility, Detoxification Beds, Onsite Medical Care, Primary Care Clinic and Assertive Community Treatment Team.

B. BASIS OF PRESENTATION – The accompanying financial statements present all activities under the direction of the UNC Health Care Board of Directors. The financial statements for UNC Health Care are presented as a pro forma compilation of the various statements generated by its separate entities. UNC Hospitals, REX, Chatham, UNCPN, High Point and Caldwell issue their own audited financial statements while UNCFP is included as a part of the audited statements for the UNC-CH.

In compiling the financial statements for UNC Health Care, significant intercompany transactions and balances between the related parties have been eliminated. In addition, while the general statutes refer to only the clinical operations of the School of Medicine, which are reported through UNCFP, this annual report includes the assets, liabilities and net assets of UNCFP, which are included in the audited financial statements for the UNC-CH.

C. BASIS OF ACCOUNTING – The financial statements of the various entities have been prepared using the accrual basis of accounting for UNC Hospitals, REX, Chatham, UNCPN, High Point and Caldwell and the modified accrual basis of accounting for UNCFP. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. When preparing the financial statements, management makes estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from the estimates. For UNCFP, their monthly financials are maintained on a cash basis, and then at year-end, adjustments are made to accrue all known material amounts for revenue and expense.

D. CURRENT AND NONCURRENT DESIGNATION – Assets are classified as current when they are expected to be collected within the next 12 months or consumed for a current expense in the case of cash or prepaid items. Liabilities are classified as current if they are due and payable within the next 12 months.

E. OPERATING AND NONOPERATING ACTIVITIES – Revenues and expenses are classified as operating or nonoperating in the accompanying Statements of Revenues, Expenses and Changes in Net Position. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as charges for inpatient and outpatient services as well as for external customers who purchase medical services or supplies. Operating expenses are all expense transactions incurred other than those related to capital and noncapital financing or investing activities. Nonoperating revenues include activities that have the characteristics of nonexchange transactions. Revenues from nonexchange transactions "and donations" that represent subsidies or gifts, as well as investment income "and gain (loss) on disposal of capital assets," are considered nonoperating since these are investing, capital or noncapital financing activities.

F. CASH AND CASH EQUIVALENTS – This classification includes all highly liquid investments with an original maturity of three months or less when purchased including deposits held by the State Treasurer in the short-term investment fund (STIF). The STIF account has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.

The UNC-CH manages the funds of UNCFP as authorized by the University of North Carolina Board of Governors pursuant to N.C.G.S. 116-36.2 and Section 600.2.4 of the Policy Manual of the University of North Carolina. Special funds and funds received for services rendered by health care professionals pursuant to N.C.G.S 116-36.1(h) are invested in the same manner as the State Treasurer is required to invest. Investments of various funds may be pooled unless prohibited by statute or by terms of the gift or contract. The UNC-CH utilizes investment pools to manage investments and distribute investment income. Shares in the temporary pool trade at a fixed value of $1 per share.

G. INVESTMENTS – This classification includes marketable debt and equity securities with readily determinable fair values, including assets whose use is limited and is measured at fair value. Investment income or loss (including realized and unrealized gains and losses on investments, interest and dividends) is included in nonoperating income (loss). The calculation of realized gains and losses is independent of a calculation of the net change in the fair value of investments.

H. PATIENT ACCOUNTS RECEIVABLE, NET – Net patient accounts receivable consist of unbilled (in-house patients, inpatients discharged but not final billed and outpatients not final billed) and billed amounts. Payment of these charges comes primarily from managed care payors, Medicare, Medicaid and, to a lesser extent, the patient. The amounts recorded in the financial statements are net of indigent care, contractual allowances and allowances for bad debt to determine the net realizable value of the accounts receivable balance.

Reserves for these deductions are recorded based on the historical collection percentage realized for each payor and projections for future collection rates. Flexible payment arrangements with selected payors have been established to optimize collection of past-due accounts, and any amounts payable beyond one year are classified as noncurrent assets.

I. ESTIMATED THIRD-PARTY SETTLEMENTS – Estimated third-party amounts represent settlements with Medicare, Tricare and Medicaid programs that may result in a receivable or a payable. Reimbursement for cost-based items is paid at a tentative interim rate with final settlement determined after submission of annual cost reports and audits thereof by fiscal intermediaries. Final settlements under the Medicare and Medicaid programs are based on regulations established by the respective programs and as interpreted by fiscal intermediaries. The classification of patients under the Medicare and Medicaid programs as well as the appropriateness of their admission is subject to review. Several years of cost reports are currently under review. Beginning in 2012, UNC Health Care's physician and hospital entities receive supplemental reimbursement for Medicaid via the Upper Payment Limit methodology.

J. INVENTORIES – Inventories consist of medical and surgical supplies, pharmaceuticals, prosthetics and other supplies that are used to provide patient care by service departments. Inventories are stated at the lower of cost or market on the FIFO (first-in, first-out) basis.

K. OTHER ASSETS AND RECEIVABLES – Other assets and receivables relate to items such as sales tax refunds due from the North Carolina Department of Revenue, amounts due from State agencies, and billings to outside companies for ancillary testing.

L. ASSETS WHOSE USE IS LIMITED OR RESTRICTED – Current assets whose use is limited or restricted include the debt service funds established with the trustee in accordance with the bond indenture agreements and donor restrictions. The debt service funds are used to pay bond interest and principal as it becomes due.

Noncurrent assets whose use is limited or restricted include the bond proceeds for construction projects, the funds required by the bond indenture agreements, funds in the maintenance reserve fund that will be used to acquire or construct future property, plant or equipment and the money on deposit with the Liability Insurance Trust Fund.

M. PROPERTY, PLANT AND EQUIPMENT – Property, plant and equipment are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred during the period of construction are capitalized.

Assets under capital lease are stated at the present value of the minimum lease payments at the inception of the lease.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally three to 20 years for equipment, 10 to 40 years for buildings and fixed equipment and five to 25 years for general infrastructure and building improvements. Assets under capital leases and leasehold improvements are depreciated over the related lease term, generally periods ranging from five to seven years.

N. OTHER NONCURRENT ASSETS – Other noncurrent assets include amounts for long-term payment arrangements for patient accounts receivable, bond issuance costs-net of amortization and investments in affiliates.

O. NOTES AND BONDS PAYABLE – Notes and bonds payable represent debt issued for the construction of buildings and the acquisition of equipment. The current amount is the portion of bonds due within one year, and the balance is reflected as noncurrent.

The bonds carry interest rates ranging from 0.02 percent to 7.00 percent. The various bond series have fixed, variable or synthetic rates with final maturity in fiscal year 2045. Bonds payable are reported net of unamortized discount, premium and deferred loss on refundings. Amortization of these amounts is done using either the effective interest method or the straight-line method. The notes payable carry various interest rates ranging from 0.0 percent to 11.02 percent with a final maturity in fiscal year 2026.

P. OTHER CURRENT LIABILITIES – Other current liabilities represent funds held for others and amounts due to patients or third parties for credit balances.

Q. COMPENSATED ABSENCES – Compensated absences represent the liability for employees with accumulated leave balances earned through various leave programs. These amounts would be payable if an employee terminated employment. Employees earn leave at varying rates depending upon their years of service and the leave plan in which they participate.

R. NET POSITION – Net Position represents the difference between assets and liabilities. Due to the complexities of consolidating these entities, only a combined number is shown for Net Position.

Normally, under generally accepted accounting principles, the Net Position category would be further categorized as the amounts (1) Invested in Capital Assets, Net of Related Debt, (2) Restricted – Expendable and (3) Unrestricted.

S. NET PATIENT SERVICE REVENUE – Patient service revenue is recorded at established rates when services are provided with contractual adjustments, estimated bad debt expenses and services qualifying as charity care deducted to arrive at net patient service revenue. Contractual adjustments arise under reimbursement agreements with Medicare, Medicaid, certain insurance carriers, health maintenance organizations and preferred provider organizations, which provide for payments that are generally less than established billing rates. The difference between established rates and the estimated amount collectible is recognized as revenue deductions on an accrual basis.

Charity care represents health care services that were provided free of charge or at amounts that are less than the established rates to individuals who meet the criteria of UNC Health Care's charity care and uninsured policy. For UNC Hospitals and UNCFP, uninsured patients receive a 40 percent discount for medically necessary treatment. Charity care provided is not considered to be revenue since no effort is made to collect accounts that fall under this policy.

Medicare reimburses for inpatient acute care services under the provisions of the Prospective Payment System (PPS). Under PPS, payment is made at predetermined rates for treating various diagnoses and performing procedures that have been grouped into defined diagnostic-related groups (DRGs) applicable to each patient discharge rather than on the basis of the Hospitals' allowable charges. Psychiatric and Rehabilitation inpatient services are reimbursed under separate programs.

A prospective payment system for outpatient services was implemented Aug. 1, 2000 and is based on ambulatory payment classifications. It applies to most hospital outpatient services other than ambulance, rehabilitation services, clinical diagnostic laboratory services, dialysis for end-stage renal disease, nonimplantable durable medical equipment, prosthetic devices and orthotics.

Medicaid reimburses inpatient services on an interim basis under a Prospective Payment System. Medicaid uses the Medicare DRG system with some modifications. Medicaid reimburses outpatient services on an interim basis at an agreed-upon percent of charges, but is settled based on 90 percent of documented cost for all services except hearing aids, durable medical equipment (DME), outpatient pharmacy laboratory, ambulance services and home health.

Hospital payments for Medicare and Medicaid services are made based on a tentative reimbursement rate with final settlement determined after submission of the appropriate cost reports by the entities within UNC Health Care. Medicaid reimburses physician services using a fee schedule that approximates ninety-five percent (95 percent) of allowable Medicare rates. Some UNC Health Care Physicians receive supplemental payments under the Upper Payment Limit Program in addition to their Medicaid reimbursement as a replacement to filing a Medicaid Cost report for periods after June 30, 2010.

T. MEDICAL AND SURGICAL SUPPLIES – Medical and surgical supplies represent the items used to provide patient care. These include instruments, special medical devices and pharmaceuticals.

U. MEDICAL MALPRACTICE COSTS – Medical malpractice costs represent the actuarially determined contributions required for self-insured funding or commercial premiums for third-party coverage. The coverage is intended to include both reported claims and claims that have been incurred but not yet reported.

V. MEDICAL SCHOOL TRUST FUND – Medical School Trust Fund (MSTF) expenses represent an assessment of 4.6 percent of net patient service revenue. The MSTF funds are at the Dean's discretion for the support of projects such as program development and recruitment incentives for new department chairs.

W. DONATED SERVICES – No amounts have been included for donated services since no objective basis is available to measure the value of such services. However, a substantial number of volunteers donated significant amounts of their time to the operations of UNC Health Care.

X. CONCENTRATIONS OF CREDIT RISK – UNC Health Care provides services to a relatively compact area surrounding the Research Triangle Park, without collateral or other proof of ability to pay. Concentration of credit risk with respect to patient accounts receivable are limited due to large numbers of patients served and formalized agreements with third-party payors. Significant accounts receivable are dependent upon the performance of certain governmental programs, primarily Medicare and North Carolina Medicaid for their collectability. Management does not believe there are significant credit risks associated with these governmental programs.

NOTE 2 // ESTIMATED THIRD-PARTY SETTLEMENTS

For Medicare and Medicaid, reported amounts reflect the net difference between the filed cost report settlements and amounts reserved for possible future audit findings. Tricare/Champus is a federal insurance program for eligible active duty and retired military personnel and their dependents. Tricare/Champus makes payments on an interim basis. Upon completion of the Medicare Cost Report, Tricare will reimburse certain portions of direct medical and paramedical education and capital costs from the Medicare Cost Report.

NOTE 3 // CAPITAL ASSETS

A summary of capital assets as of June 30 was:

	FY2016	FY2015
Land and Improvements	132,509,076	130,413,740
Buildings and Improvements	1,522,836,424	1,296,737,213
Equipment	1,120,321,631	1,044,657,837
Computer Software	186,868,983	176,629,567
Goodwill	7,704,529	7,704,529
Construction in Progress	194,129,891	292,980,231
Gross PP&E	**3,164,370,533**	**2,949,123,117**
Accumulated Depreciation	(1,614,429,615)	(1,476,585,859)
Net PP&E	**$1,549,940,918**	**$1,472,537,258**

NOTE 4 // LONG-TERM DEBT

A summary of outstanding bond debt and related issuance costs as of June 30 was:

	FY2016	FY2015
Chatham Series 207 Bonds	24,940,000	25,750,000
REX Series 2010A Bonds	100,210,000	105,385,000
REX Series 2015A Bonds	50,000,000	50,000,000
REX Series 2015B Bonds	99,675,000	11,000,000
UNCH Series 2001 Bonds	90,200,000	92,000,000
UNCH Series 2003 Bonds	86,575,000	91,665,000
UNCH Series 2005 Bonds	0	0
UNCH Series 2009 Bonds	26,700,000	29,505,000
UNCH Series 2010 Bonds	39,240,000	41,280,000
FACE VALUE OF BONDS OUTSTANDING	**517,540,000**	**446,585,000**
Deferred Costs – Premium on Issuance	3,465,349	3,875,209
Arbitrage Rebate Payable	0	425,034
NET VALUE OUTSTANDING	**521,005,349**	**450,885,243**
Current Portion of Bonds	18,360,000	17,720,000
Current Portion of Notes	2,086,895	2,540,628
Other Current Debt	5,611,017	6,945,894
TOTAL CURRENT BONDS AND NOTES	**26,057,912**	**27,206,522**
Noncurrent Portion of Bonds	502,645,349	433,165,243
Noncurrent Portion of Notes	31,982,311	33,581,090
Other Noncurrent Debt	15,338,360	20,543,372
TOTAL NONCURRENT BONDS AND NOTES	**549,966,020**	**487,289,705**
Deferred Costs – Loss on Refunding	(8,993,613)	(9,813,733)
Hedging Liability	19,422,898	16,730,009
DEFERRED BOND ACTIVITY	**10,429,285**	**6,916,276**

As currently constituted, UNC Health Care has no authority to issue debt. Only the individual entities within UNC Health Care have assets and revenue that can be pledged as collateral for the debt.

Annual requirements to pay principal and interest (including swap arrangements) on the bonds outstanding at June 30, 2016 are:

FISCAL YEAR	PRINCIPAL	INTEREST	TOTAL
2017	18,360,000	16,640,340	35,000,340
2018	19,180,000	15,911,043	35,091,043
2019	19,880,000	15,151,582	35,031,582
2020	20,615,000	14,412,867	35,027,867
2021	21,510,000	13,556,122	35,066,122
2022-2026	120,070,000	52,894,157	172,964,157
2027-2031	145,990,000	31,553,049	177,543,049
2032-2045	151,935,000	29,764,625	181,699,625
TOTAL	**$517,540,000**	**$189,883,785**	**$707,423,785**

Annual requirements to pay principal and interest on the outstanding notes and capital leases payable at June 30, 2016 are:

FISCAL YEAR	PRINCIPAL	INTEREST	TOTAL
2017	7,697,912	1,042,547	8,740,459
2018	7,635,072	930,395	8,565,467
2019	5,750,403	733,498	6,483,901
2020	7,353,901	559,675	7,913,576
2021	9,176,219	379,040	9,555,259
2022-2026	17,405,076	99,707	17,504,783
TOTAL	**$55,018,583**	**$3,744,862**	**$58,763,445**

NOTE 5 // PENSION PLANS

UNC Health Care has a variety of retirement plans available to its permanent full-time employees. The majority of employees of UNC Hospitals and UNCFP are members of the Teachers' and State Employees' Retirement System (TSERS) as a condition of employment. TSERS is a cost-sharing, multiple-employer, defined-benefit pension plan established by the State to provide pension benefits for employees of the State, its component units and local boards of education. The plan is administered by the North Carolina State Treasurer. Graduate medical residents, temporary employees and permanent part-time employees with appointments of less than 30 hours per week are not covered by the plan.

The Optional Retirement Program (the Program) is a defined contribution retirement plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Administrators and eligible faculty of the University may join the Program instead of the Teachers' and State Employees' Retirement System. The Board of Governors of The University of North Carolina is responsible for the administration of the Program. Participants in the Program are immediately vested in the value of employee contributions. The value of employer contributions is vested after five years of participation in the Program. Participants become eligible to receive distributions when they terminate employment or retire.

REX sponsors a single-employer, defined-benefit retirement plan available to eligible employees. The benefit formula is based on the highest five consecutive years of an employee's compensation during the 10 plan years preceding retirement. There are no employee contributions to the plan.

During the year ended June 30, 2015, the Plan was amended to freeze the Plan's accrued benefits for all Plan participants. As a result, the net pension liability decreased significantly during the year ended June 30, 2016, and REX recorded a gain on change in pension plan of $75,741,000 as a special item following the excess of revenues and gains over expenses and losses in the statement of revenues, expenses and changes in net position.

Funding amounts for all of the plans are based upon actuarial calculations.

In addition to the employer plans, UNC Health Care employees may elect to participate in any number of deferred compensation and Supplemental Retirement Income Plans. These include 401(k) plans, 403(b) plans and 457 plans. All costs of administering and funding the plans are the responsibility of the participants. REX employees may contribute to a tax-deferred annuity plan through which REX matches one half of each participant's voluntary contributions on a graduated scale based on length of service, not to exceed 5 percent of the participant's annual salary.

NOTE 6 // OTHER EMPLOYMENT BENEFITS

UNC Hospitals and UNCFP participate in State-administered programs that provide health insurance and life insurance to current and eligible former employees. Funding for the health care benefit is financed on a pay-as-you-go basis based upon actuarial reports. UNC Hospitals and UNCFP assume no liability for retiree health care benefits provided by the programs other than their required contributions.

UNC Hospitals and UNCFP participate in the Disability Income Plan of North Carolina (DIPNC). DIPNC provides short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System. UNC Hospitals and UNCFP assume no liability for long-term disability benefits under the Plan other than their contribution.

REX offers a full menu of employment benefits to its employees through various third-party carriers. These include medical insurance, dental coverage, short-term and long-term disability benefits and life insurance coverage.

More information about these plans can be found in the individual audit reports of the various entities.

NOTE 7 // RISK MANAGEMENT

UNC Health Care is exposed to various risks of loss related to torts; theft of, damage to and the destruction of assets; errors and omissions; employee injuries and illnesses; natural disasters; medical malpractice; and various employee plans for health, dental and accident. These exposures to loss are handled by a combination of methods, including participation in State-administered insurance programs, purchase of commercial insurance and self-retention of certain risks. There have been no significant reductions in insurance coverage from the previous year.

Liability Insurance Trust Fund – UNC Hospitals and UNCFP participate in the Liability Insurance Trust Fund (the Fund), a claims-servicing public entity risk pool for professional liability protection. The Fund acts as a servicer of professional liability claims, managing separate accounts for each participant from which the losses of that participant are paid. Although participant assessments are determined on an actuarial basis, ultimate liability for claims remains with the participants and, accordingly, the insurance risks are not transferred to the Fund.

Additional disclosures relative to the funding status and obligations of the Fund are set forth in the audited financial statements of the Liability Insurance Trust Fund for the Years Ended June 30, 2016, and June 30, 2015. Copies of this report may be obtained from The University of North Carolina Liability Insurance Trust Fund, 211 Friday Center Drive, Hedrick Building - Room 2029, Chapel Hill, NC, 27517.

NOTE 8 // ESCROW FOR CERTIFIED PUBLIC EXPENDITURES (CPEs)

With the help of the North Carolina Hospital Association, UNC Health Care has entered into an agreement with other Public Hospitals in North Carolina to receive the benefit of additional Certified Public Expenditures (CPEs). By making additional CPEs available, the Public Hospitals risk possible Disproportionate Share of Hospital (DSH) overpayments that would require repayment to state or federal agencies. In order to mitigate the Public Hospitals' risk, UNC Health Care established a reserve fund to be held in escrow. This fund will reimburse participating Public Hospitals for any repayments that should result from this program. The UNC Health Care Enterprise Fund transferred $14,844,132 for 2012 CPE and $10,732,004 for 2013 CPE to the Escrow Agent, First Citizens Bank & Trust Company. The 2012 CPE was deemed no longer necessary, and therefore funds were distributed back to UNC Health Care.

NOTE 9 // RELATED PARTY TRANSACTIONS

The Medical Foundation of North Carolina, Inc. – UNC Hospitals and UNCFP are participants in The Medical Foundation of North Carolina, Inc., a nonprofit foundation for the University of North Carolina at Chapel Hill and UNC Hospitals, which solicits gifts and grants for both entities. The Board of Directors of the Medical Foundation administers the funds of the Foundation. Transactions are recorded only by the Foundation. If the Foundation were to purchase any equipment for UNC Hospitals, then the amount would be recorded at the time of receipt on UNC Hospitals' financial statements.

UNC Health Care System Enterprise Fund – The Board of Directors of UNC Health Care authorized and approved the creation of the UNC Health Care System Enterprise Fund (The System Fund) to support UNC Health Care's mission and vision to be the nation's leading public academic health care system. Pursuant to a memorandum of understanding effective July 1, 2005, UNC Hospitals, UNCFP, REX and the UNC-CH School of Medicine agreed to finance the Enterprise Fund. The System Fund enables fund transfers among entities in the health system in support of the Board's vision to be the nation's leading public academic health care system.

The System Fund assesses, holds and allocates funds across the entities of UNC Health Care. Initially formed as the Enterprise Fund to facilitate investments in support of the clinical, academic and research missions of UNC Health Care and the UNC School of Medicine, the Enterprise Fund today exists as a subaccount within the System

Fund. Since its formation, the System Fund has been used to enable additional types of transfers between entities of UNC Health Care. As such, the Enterprise Fund, Outreach Fund, Patient Safety Fund, Recruitment Fund, and Shared Administrative Services Fund each function as subaccounts of the System Fund.

Henderson County Hospital Corporation d/b/a Margaret R. Pardee Memorial Hospital (HCHC) – Henderson County is the sole member of HCHC, a North Carolina not-for-profit corporation, which is in turn the sole member of Henderson County Urgent Care Centers, Inc. and Western Carolina Medical Associates, Inc. HCHC was created by Henderson County to provide for the operation of a community hospital in Henderson County, North Carolina that is dedicated to serving the health care needs of Henderson County citizenry. On June 22, 2011, HCHC signed a management service agreement engaging the Hospitals to conduct and effectively manage the day-to-day operations of Margaret R. Pardee Memorial Hospital and HCHC's affiliated operations over a term of 10 years. On September 4, 2013, this agreement was extended to a term of 25 years.

Johnston Health Services Corporation – Effective February 1, 2014, Johnston Memorial Hospital Authority (JMHA) and UNC Health Care entered into a Master Agreement to form Johnston Health Services Corporation (JHSC), a joint venture created to achieve the long-term vision of providing high-quality health care to the residents of Johnston County, North Carolina. Oversight and governance of the joint venture is controlled by a Board of Directors consisting of appointees from both JMHA and UNC Health Care. UNC Health Care manages the day-to-day operations of JHSC under the terms of a Management Services Agreement entered into and effective November 1, 2013. UNC Health Care has a 35.25 percent membership interest in JHSC.

Nash Health Care Systems – Nash Health Care Systems is a nonprofit hospital authority composed of Nash General Hospital, Nash Day Hospital, the Bryant T. Aldridge Rehabilitation Center, Community Hospital and Coastal Plain Hospital. It serves Nash, Edgecombe, Halifax, Wilson and Johnston counties, but draws patients from beyond these areas as well.

Nash Health Care Systems signed a management service agreement engaging UNC Health Care to conduct and manage its operations effective April 1, 2014.

Wayne Health Corporation – Wayne Health Corporation is a private, not-for-profit health corporation located in Goldsboro, North Carolina that operates Wayne Memorial Hospital, Wayne Health Physicians, Wayne MRI, Wayne Health Enterprises, American Management Associates, Wayne Health Properties, and Wayne Health Foundation. It serves patients primarily from Wayne and neighboring counties. Wayne Health Corporation signed a management services agreement with UNC Health Care on January 1, 2016 to provide certain management services over an initial term of 10 years.

Lenoir Memorial Hospital, Inc. – Lenoir Memorial Hospital, Inc. is a private, not-for-profit hospital located in Kinston, North Carolina that operates Lenoir Memorial Hospital and several physician practices. It serves patients primarily from Lenoir and neighboring counties. Lenoir Memorial Hospital, Inc. signed a management services agreement with UNC Health Care on May 17, 2016 to provide certain management services over an initial term of 10 years.

The John REX Endowment – The John REX Endowment (Endowment) operates as a 501(c)(3) corporation and is independent of the Board of Directors of UNC Health Care. Its purpose is to advance the health and well-being of the residents of the greater Triangle area, with specific funds set aside for indigent care and to make grants to support health services, education, prevention and research. In discharging its purposes, priority consideration will be given to any funding requests from REX, UNC Health Care and their affiliates. The funding source for the Endowment is the $100 million transfer that came from UNC Health Care in April 2000.

NOTE 10 // COMMUNITY BENEFITS

In addition to providing care without charge, or at amounts less than established rates to certain patients identified as qualifying for charity care, UNC Health Care also recognizes its responsibility to provide health care services and programs for the benefit of the community, at no cost or at reduced rates. UNC Health Care sponsors many community health initiatives, including breast and prostate cancer screenings, cardiovascular and pulmonary awareness and diabetes education programs that ultimately result in the overall improved health of our community. UNC Health Care also provides contributions, cash and in-kind, to various charitable and community organizations. The costs of these programs are included in operating expenses in the accompanying pro forma statements of revenues and expenses.

UNC Health Care and its entities participate in the North Carolina Hospital Association's (NCHA's) Advocacy Needs Data Initiative (ANDI) to quantify their Community Benefit. The data for calculating the FY16 Community Benefit is being processed and will be included in NCHA's ANDI report in spring 2017.

UNC HEALTH CARE

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